# THE PROBLEMS AND PROMISE OF "ENHANCED BUSINESS JUDGMENT"

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## INTRODUCTION

In *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court created a new standard of review, enhanced business judgment, to monitor the decision of target directors to enact defensive tactics against a hostile tender offer.[1] Shortly thereafter, the Delaware Supreme Court applied enhanced business judgment to monitor target directors' actions when a corporation is in a "*Revlon* mode."[2] Cases after *Unocal* labeled this new standard of review as an "intermediate level of judicial review."[3] One court wrote that "*Unocal* has correctly been described as 'the most innovative

1. 493 A.2d 946, 955 (Del. 1985) (noting that "there is an enhanced duty which calls for judicial examination at the threshold. . ."); *see also* Samuel C. Thompson, Jr., *The Missing Link in Sarbanes-Oxley: Enactment of the "Change of Control Board" Concept, or Extension of the Audit Committee Provisions to Mergers and Acquisitions*, 63 Bus. Law. 81, 87-88 (2007) ("In the famous Case of *Unocal* . . . the Delaware Supreme Court adopted what has become known as the 'enhanced business judgment rule' . . .").

2. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989) (applying enhanced business judgment to *Revlon*); *see infra* Part II.B. Only a few fact patterns currently trigger "*Revlon*" analysis. For a discussion of when corporations are in a "*Revlon* mode" see *infra* note 137.

3. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 947 (Del. 2003) (Steele, J., *dissenting*) (noting that *Unocal's* intermediate standard of review requires judicial review); Kallick v. Sandridge Energy, Inc., 68 A.3d 242, 258 (Del. Ch. 2013) (noting that *Unocal* is a "flexible, intermediate standard of review"); Koehler v. NetSpend Holdings Inc., No. 8373-VCG, 2013 WL 2181518, at *11 (Del. Ch. May 21, 2013) ("[E]nhanced scrutiny is a 'middle ground' between deference to the board under the business judgment rule and skepticism toward the board under entire fairness review."); Keyser v. Curtis, No. 7109-VCN, 2012 WL 3115453, at *12 (Del. Ch. July 31, 2012) ("a specific iteration of the intermediate standard of review"), *aff'd sub nom.*, Poliak v. Keyser, 65 A.3d 617 (Del. 2013); Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011) ("Enhanced scrutiny is Delaware's intermediate standard of review."); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 93 (Del. Ch. 2011) ("[T]he Delaware Supreme Court in *Unocal* created an intermediate standard of review applying enhanced scrutiny to board action before directors would be entitled to the protections of the business judgment rule."); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 28 (Del. Ch. 2010) ("the intermediate standard of enhanced scrutiny, typically referred to as the *Unocal* test"); Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 331 (Del. Ch. 2010) ("*Unocal*'s intermediate review standard"); *In re* Unitrin, Inc. S'holders Litig., Nos. 13656, 13699, 1994 WL 698483 (Del. Ch. Oct. 13, 1994) (noting that *Unocal* provides an "intermediate standard of judicial scrutiny"), *rev'd sub nom.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1123-24 (Del. Ch. 1990) (applying the "intermediate form of business judgment review identified in *Unocal*"); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 658 (Del. Ch. 1988) (calling *Unocal* an intermediate level of review); Robert M. Bass Grp. v. Evans, 552 A.2d 1227, 1239 (Del. Ch. 1988) (citing *Unocal* as an intermediate standard of review); City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 796 (Del. Ch. 1988) (arguing that the *Unocal* "created a new intermediate form of judicial review"); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (labeling *Unocal* as "a more flexible, intermediate form of judicial review").

and promising' case in our corporation law and one whose insights 'will [] continue to resonate with judges.'"[4]

Enhanced business judgment has the potential to be such a useful tool in the array of standards of review that extending this standard to other aspects of corporate law besides tender offer and *Revlon* contexts can be tempting. Therefore, in order to be able to evaluate which scenarios are suitable for review under this standard, this Article analyzes the Delaware Supreme Court's original design for enhanced business judgment review, how this review currently operates, and its premises. Part I of this Article briefly describes various standards of review to showcase why the Delaware Supreme Court felt the need to create an additional standard of review. Part I then traces the creation of enhanced business judgment and evaluates the efficacy of this standard. Part II explains the logic of enhanced business judgment so as to understand the issues to which this standard of review can respond and the topics to which enhanced business judgment has thus far been applied. Based on the dissection of enhanced business judgment review that Part II provides, Part III tweaks the standard to provide a more meaningful review. Thereafter, Part III discusses two topics that could merit review under this standard as well as the costs and benefits of extending enhanced review. Finally, Part III considers the effect, if any, that a shareholder vote should have on the applicable standard of review.

## I. THE COMPETITION AND THE CONTENDER

### *A. The Competition*

It is only by placing the *Unocal* standard of review among others used by Delaware courts that the nature of the problem emerges: Delaware's standards of review diverge widely, thereby creating a cavernous gap among them. In a spectrum demarcating when directors will be liable for breaching their fiduciary duties, the business judgment rule sits on the end of the spectrum where imposition of liability is rare.[5] The reason for the

4. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 31 (Del. Ch. 2010) (citation omitted) (quoting William T. Allen, Jack B. Jacobs, & Leo E. Strine, Jr., *The Great Takeover Debate: A Mediation on Bringing the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1093 (2002)).

5. Peter V. Letsou, *Implications of Shareholder Diversification on Corporate Law and Organization: The Case of the Business Judgment Rule*, 77 CHI.-KENT L. REV. 179, 179-80 (2001) ("As a practical matter, the presumption established by the business judgment rule is all but impossible to overcome, at least in cases where directors lack any apparent conflict of interest . . . . So in Delaware, the business judgment rule goes much of the way towards putting disinterested business decisions beyond judicial scrutiny."); Lyman

infrequency of liability results from two factors. First, the rule presumes that the directors "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[6] Plaintiffs face an uphill battle rebutting this presumption.[7] Second, unless the plaintiff can make a prima facie case that the directors violated one of their fiduciary duties,[8] the rule allows the court to review only the decision-making process. The board's decision, however, is not reviewable for its wisdom or reasonableness.[9] While some formulations of the business judgment rule state that courts can review the decision for its rationality or for waste,[10] even that standard makes the board's decision virtually unreviewable.[11] Since plaintiffs face a high hurdle to generate facts that support a showing of fiduciary breach, they have scored few victories under the business judgment rule.[12] Such a pro-board standard of

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Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. 787, 791-92 (1999) (noting that plaintiffs rarely prevail when the business judgment rule applies). *But see* Smith v. Van Gorkom, 488 A.2d 858, 881 (Del. 1985) (applying business judgment rule to board's decision to enter into third-party merger agreement, but finding board violated the rule).

6. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

7. *See supra* text accompanying note 6; *see also* In re Citigroup S'holder Litig., 964 A.2d 106, 125 (Del. Ch. 2009) ("Accordingly, the burden required for a plaintiff to rebut the presumption of the business judgment rule . . . is a difficult one).

8. Williams v. Geier, 671 A.2d 1368, 1378 (Del. 1996) ("Only by demonstrating that the Board breached its fiduciary duties may the presumption of the business judgment rule be rebutted."); State of Wis. Inv. Bd. v. Bartlett, No. 17727, 2000 Del. Ch. LEXIS 42, at *11–12 (Del. Ch. Feb. 24, 2000) (reasoning that unless the presumption of the business judgment rule is sufficiently rebutted by the plaintiff creating a "reasonable doubt about self-interest or independence, the Court must defer to the discretion of the board"); *see also* 1 STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS, 53–55 (6th ed. 2009) (supporting the idea that a violation of fiduciary duties of corporate directors allows the court to review more than the decision-making process).

9. Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 787 (2006) ("The business judgment rule therefore builds a prophylactic barrier by which courts pre-commit to resisting the temptation to review the merits of the board's decision.").

10. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.") (citations omitted); *see also* Julian Velasco, *Structural Bias and the Need For Substantive Review*, 82 WASH. U. L.Q. 821, 840 (2004) ("The outer limit for substantive overreaching—irrationality or waste—is virtually unworthy of mention.").

11. Velasco, *supra* note 10, at 830 (stating that judicial review of the rationality of the board's decision makes the "business judgment rule 'presumption' . . . nearly irrebuttable with respect to substance").

12. *See supra* text accompanying note 5. *See* Rales v. Blasband, 634 A.2d 927, 933 (Del. 1996) (explaining that plaintiffs seldom success in derivative suits because "stockholder plaintiffs must overcome the powerful presumptions of the business judgment rule"); Polk v. Goode, 507 A.2d 531, 535-36 (Del. 1986) (acknowledging that

review is deliberate, as many excellent rationales for the business judgment rule exist.[13] One Delaware chancery court explained well one of the most important of these reasons:

> The business judgment rule serves to protect and promote the role of the board as the ultimate manager of the corporation. Because courts are ill equipped to engage in *post hoc* substantive review of business decisions, the business judgment rule 'operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.'[14]

In contrast, at the other end of the spectrum are two standards of review: the *Blasius* test, and the entire fairness test. The *Blasius* test applies to those situations where directors' primary purpose is to disenfranchise their shareholders; in that event, directors must demonstrate a compelling justification for their actions.[15] Two reasons account for the courts' infrequent invocation of the *Blasius* test. One is that the factual limitations of *Blasius* make the test inapplicable to voting situations outside of voting for directors.[16] Thus, in *Blasius*, Chancellor Allen recognized this point by distinguishing the facts of that case from those in *Unocal*, noting the latter involved issues of the "corporation's power over its property, or with respect to its rights or obligations"[17] while the *Blasius* facts involve

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"notwithstanding the plaintiffs[']. . .difficult task in overcoming the protections of the business judgment rule," the settlement negotiated by the directors satisfied their fiduciary duties); Paula J. Dalley, *The Business Judgment Rule: What You Thought You Knew*, 60 Cons. Fin. L. Q. Rep. 24, 25 (2006) (arguing that it is "almost impossible" for a plaintiff to overcome the presumption of the business judgment rule).

13. Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 603-04 (2013) (explaining that the business judgment rule maximizes shareholder value by enabling directors to take risks without fear of being held personally liable for potential losses, encourages qualified individuals to become directors, prevents judges from making business decisions, and ensures that directors, not shareholders, manage the corporation).

14. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 746 (Del. Ch. 2005) *aff'd,* 906 A.2d 27 (Del. 2006) (citation omitted) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993)).

15. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659, 661–62 (Del. Ch. 1988).

16. *See, e.g.*, Mercier v. Inter-Tel (Delaware) Inc., 929 A.2d 786, 809 (Del. Ch. 2007) (noting that MM Companies v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003) signaled "that the stringency of the *Blasius* approach should be reserved largely for director election contests or election contests having consequences for corporate control"); *see also In re* MONY Group, Inc. S'holder Litig., 853 A.2d 661, 675 n. 51 (Del. Ch. 2004) ("*Blasius* is not easily or readily applied outside the context of matters touching on directorial control, as its demanding standard could unduly limit the legitimate exercise of directorial power and discretion in other contexts.").

17. *Blasius*, 564 A.2d at 660 (Del. Ch. 1988). *But see infra* Part II.B (describing

the "ideological underpinning upon which the legitimacy of directorial power rests."[18] The second is that the courts are reluctant to invoke the *Blasius* test given that it is virtually outcome determinative: once the directors have the requisite purpose, it appears impossible to provide the court with a sufficiently compelling justification so as to pass the test.[19] As a result, then Vice-Chancellor Strine has argued that the *Blasius* test is effectively a holding, rather than a true standard of review.[20]

Still stringent but somewhat less so, the entire fairness test is the standard of review for conflict-of-interest transactions.[21] A conflict of

chancery court proposal to apply *Unocal* review to *Blasius* fact pattern); *infra* Part III.B (discussing the appropriate voting fact-patterns for *Blasius* review).

18. *Blasius*, 564 A.2d at 659.

19. Thus far, only five cases, four by the Delaware chancery courts and one by the Delaware Supreme Court, have triggered the *Blasius* test, and only one passed. *See* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1132 (Del. 2003) (invalidating bylaw amendment that expanded the size of Liquid Audio's board because of lack of compelling justification under *Blasius*); *Mercier*, 929 A.2d at 787 (finding that a special committee satisfied the compelling justification under *Blasius* for postponing a shareholder vote on a merger that independent directors believed was in the best interests of shareholders); Chesapeake Corp. v. Shore, 771 A.2d 293, 297 (Del. Ch. 2000) (striking down a supermajority bylaw amendment because it interfered with a shareholder vote and lacked a compelling justification under *Blasius*); State of Wis. Inv. Bd. v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *17-18 (Del. Ch. Dec. 4, 2000) (denying a motion for summary judgment because of the applicability of *Blasius* to the board's decision to adjourn a shareholder meeting); Carmody v. Toll Brothers, Inc., 723 A.2d 1180, 1182 (Del. Ch. 1998) (finding a cognizable *Blasius* claim regarding a "dead hand" provision because of the provision's effect on shareholders' ability to elect a board that would accept a takeover offer). *Cf. Mercier*, 929 A.2d at 788–89, 812–13 (applying a reformulated *Blasius* test to look more like the *Unocal* test, which defendant passed, but then concluding that since a chancery court cannot overrule the Delaware Supreme Court's affirmation of *Blasius*, holding that the defendant satisfied the *Blasius* test as well); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1089 (Del. Ch. 2004) (determining that *Blasius* did not apply, but if it did, the board had a compelling justification for enacting a rights plan that had an incidental burden on voting rights).

20. *Mercier*, 929 A.2d at 806 (Del. Ch. 2007) ("[T]he trigger for the test's application—director action that has the primary purpose of disenfranchisement—is so pejorative that it is more a label for a result than a useful guide to determining what standard of review should be used by a judge to reach an appropriate result.") (citations omitted); *see also infra* Part II.B (discussing the merits of *Mercier*'s argument that *Blasius* review should be replaced by enhanced business judgment).

21. *See* Kahn v. Tremont Corp, 694 A.2d 422, 428 (Del. 1997) ("Ordinarily, in a challenged transaction involving self-dealing by a controlling shareholder, the substantive legal standard is that of entire fairness"); Kahn v. Roberts, No. 12324, 1995 Del. Ch. LEXIS 151, at * 13–14 (Del. Ch. Dec. 6, 1995) (explaining that, in an interested director transaction, "courts generally will bypass the business judgment rule and conduct an entire fairness analysis on the challenged transaction"); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (holding that "where a self-interested corporate fiduciary has set the terms of a transaction and caused its effectuation, it will be required to establish the entire fairness of the transaction"); R. FRANKLIN BALOTTI & JESSIE

interest is one of several types of fact patterns that raise an issue of directors' compliance with their duty of loyalty.[22] Once the court acknowledges that plaintiffs have raised a cognizable loyalty issue, defendants bear the burden of proving "all aspects of the issue . . . as a whole since the question is one of entire fairness."[23] Thus, like the business judgment rule, the entire fairness standard of review has both a procedural and a substantive component,[24] but this is where the similarity ends. Under the entire fairness test, defendants must prove that both the board's process and its decision were fair to the corporation and to the shareholders.[25] Because the court conducts a searching and pervasive inquiry under the entire fairness review,[26] few defendants successfully satisfy this exacting scrutiny.[27]

In sum, at one end of the spectrum, directors rarely lose when courts

A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.19B at 4-172 (2011 Supp.) ("If the business judgment rule's presumption is rebutted, the burden shifts to the defendant directors to show the 'entire fairness' of the transaction.").

22. The traditional description of directors' duty of loyalty violation is that "they were greedy and put their own financial interests ahead of the interests of the corporation and its shareholders." FRANKLIN A. GEVURTZ, 1 CORPORATION LAW 321 (2d ed. 2010). "Questions of a director's duty of loyalty generally arise when the director (1) competes with the company, or (2) takes for herself a 'corporate opportunity' or (3) has some personal pecuniary interest in a corporation's decision." DAVID G. EPSTEIN, RICHARD D. FREER, 1 MICHAL J. ROBERTS & GEORGE B. SHEPHERD, BUSINESS STRUCTURES 233 (3d ed. 2007).

23. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983); *see also* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1164 (Del. 1995) ("From a procedural perspective, the breach of any *one* of the board's fiduciary duties is enough to shift the burden of proof to the board to demonstrate entire fairness."); R. FRANKLIN BALOTTI & JESSIE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.19B at 4-172 (2011 Supp.) ("If the business judgment rule's presumption is rebutted, the burden shifts to the defendant directors to show the 'entire fairness' of the transaction.").

24. Velasco, *supra* note 10 at 836.

25. *See, e.g.*, Strassburger v. Earley, 752 A.2d 557, 570 (Del. Ch. 2000) ("Under [the entire fairness test], where the controlling shareholder and the directors stand on both sides of the transaction, they bear the burden to demonstrate that the transaction was entirely fair to the corporation and the minority stockholders, both as to process and price.").

26. *See, e.g.*, *In re* Digex, Inc. S'holders Litig., 789 A.2d 1176, 1207 (Del. Ch. 2000) (noting the "careful scrutiny" required under entire fairness review); Linton v. Everett, No. 15219, 1997 Del. Ch. LEXIS 117, at *17 (Del. Ch. July 31, 1997) (holding that issuance by directors of shares to themselves did not satisfy the "rigorous standard" of entire fairness); *see also* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 4.19[B][A], at 4-172 (Supp. 2012) (describing the "heavy burden" of showing entire fairness).

27. *See* Craig W. Palm & Mark A. Kearney, *A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part I)*, 40 VILL. L. REV. 1297, 1320 (1995) (asserting that when the court applies the entire fairness standard of review, the plaintiff will likely win). *But see* Nixon v. Blackwell, 626 A.2d 1366, 1370 (Del. 1993) (holding that directors satisfied the entire fairness test in enacting a stock repurchase program limited to shareholders who were also employees).

apply the business judgment rule, and at the other end of the spectrum, directors rarely succeed when courts apply *Blasius* or the entire fairness test. Thus, when it considered board responses to hostile offers, the Delaware Supreme Court faced doctrinal choices that were both too limited and too extreme. It is therefore not surprising that the Delaware Supreme Court in *Unocal* created a standard that falls between these polar opposites. In fact, the wonder is that Delaware courts did not do so sooner.[28]

### *B. The Contender: Enhanced Business Judgment*

The Delaware Supreme Court in *Unocal* faced the issue of how to review the decision of target directors to respond to a hostile tender offer by making a conditional, selective self-tender offer.[29] At the time, two competing hardline views existed regarding such review. On the one hand, prominent corporate lawyer Martin Lipton was a strong proponent of the view that the board's response should be treated no differently from any other decision it made, and therefore should be governed by the business judgment rule.[30] Applying the business judgment rule to the board's decision to enact defensive tactics is tantamount to giving directors carte blanche to enact almost *all* defensive tactics.[31] In contrast to Mr. Lipton's view, several legal academics offered various arguments as to why the court should prohibit the board from enacting *any* defensive tactic; those arguments ranged from a lack of statutory authority for the board to act,[32] a

28. *Cf.* Velasco, *supra* note 10, at 840 (noting that as "an all-or-nothing approach, employing either the entire fairness test or the business judgment rule, is inadequate to deal with all situations," it was inevitable that courts would create an intermediate standard of review).

29. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 951–52 (Del. 1985).

30. Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 131 (1979) (contending directors have the power to enact defensive tactics and concluding that the "business judgment rule applies to takeovers in the same manner as it applies to other major business decisions"); Leo Herzel, John R. Schmidt & Scott T. Davis, *Why Corporate Directors Have a Right To Resist Tender Offers*, 3 CORP. L. REV. 107, 109 (1980) (arguing that the board's power to bargain with, and ultimately reject, merger offers benefits shareholders).

31. Because the business judgment rule is so deferential to director decisions, *supra* text accompanying notes 5–12, most or virtually all defensive tactics would pass this test.

32. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1200 (1981) (contending that directors should be passive in response to a tender offer because the corporate statute gives no role to the directors in a tender offer, unlike the statutory role given to directors in mergers and sales of all assets, and that tender offers act as "an essential safety valve to ensure that managers evaluate merger proposals in the best interests of the shareholders"); *see also* Ronald Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 849 (1981) ("The

literal argument that the offer does not involve the corporation because the offer is made to shareholders to sell their personal property,[33] and a policy argument that the tender offer is the only realistic means to unseat entrenched target management and therefore should not be stymied by defensive tactics.[34] Still others contended that target directors faced an inherent conflict of interest in dealing with hostile tender offers,[35] thereby providing the court with a third avenue for review, the entire fairness test;[36] that test would have required the target directors to bear the burden of proving that their defensive tactic was entirely fair to the corporation. In *Unocal,* the Delaware Supreme Court rejected all three of these options.

Instead, the Delaware Supreme Court in *Unocal* began with precedent involving directors' defensive tactics. Particularly relevant to the court was *Cheff v. Mathes*,[37] a case involving a shareholder derivative suit alleging that directors of the Holland Furnace Corporation improperly used corporate funds to preserve their control by causing Holland to purchase shares owned by Arnold Maremont's corporations after Maremont threatened to acquire Holland and liquidate its work force.[38] Although the Delaware Court of Chancery held that the Holland directors had breached their fiduciary duties because Maremont had not threatened the company, the Supreme Court reversed, finding that the Holland board reacted to a

statutory silence regarding tender offers may simply reflect a legislative assumption that free alienation of property is the norm, so that management's affirmative role in mergers and asset sales needs to be stated, while its nonrole in tender offers need not.").

33. MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 553 (1995) (discussing academic theories that argue that defensive tactics should be limited or prohibited so that stock can be treated like other property where only "the owner of an asset is free to accept or reject bids from others who wish to buy it").

34. Giving hostile bidder unfettered access to target shareholders "is precisely the structure reflected in the typical corporation statute" and further "the tender offer is the principal mechanism by which management can be forcibly unseated from control." *See Gilson*, *supra* note 32, at 819, 844, 847 (arguing that the "market for corporate control is the principal constraint on management self-dealing in important situations, and the tender offer is the only displacement mechanism which has the potential to effectuate that constraint"). However, as the number of proxy challenges initiated by institutional investors has increased, so has the success rate of proxy contests. Lee Harris, *Missing in Activism: Retail Investor Absence in Corporate Elections*, 2010 COLUM. BUS. L. REV. 104, 145–53 (2010).

35. Ronald J. Gilson*, Unocal Fifteen Years Later (and What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 495 (2001) (explaining that a hostile tender offer forces management to face "an inherent conflict of interest in confronting a transaction that directly threatens both their positions and their egos. Deploying defensive tactics thus resembles an interested transaction that calls for review under the rigorous entire fairness standard.").

36. *See supra* text accompanying notes 21–25.

37. 199 A.2d 548 (Del. 1964).

38. *Id.* at 552–53. Holland paid Maremont a 43% premium over the market price for its Holland shares.

"reasonable threat to the continued existence of Holland" by Maremont's plan.[39] Since the Delaware corporate statute grants corporations the right to purchase their own stock,[40] the Delaware Supreme Court recognized that the "charge here is not one of violation of statute, but the allegation is that the true motives behind such purchases were improperly centered upon perpetuation of control."[41] The court in *Cheff* then cited to *Bennett v. Propp*, a case also involving the purchase of shares with corporate funds when control was threatened, which concluded that those directors "are of necessity confronted with a conflict of interest, and an objective decision is difficult . . . [h]ence . . . the burden should be on the directors to justify such a purchase as one primarily in the corporate interest."[42] Thus, following *Bennett*'s conclusion that the board had a conflict of interest, the Delaware Supreme Court in *Cheff* held that the burden of proof should lie with the defendant board.[43]

In what would become a pivotal remark, the Delaware Supreme Court in *Cheff* cautioned that such burden-shifting did not signal that it viewed this conflict identically to the conflict-of-interest that directors face when they receive a tangible pecuniary benefit from the corporation.[44] The court provided not only a sparse explanation for its reasoning, but also an explanation written in the negative: "To say that the burden of proof is upon the defendants is not to indicate, however, that the directors have the same 'self-dealing interest' as is present, for example, when a director sells property to the corporation."[45] Attempting to clarify the different types of conflicts, the court differentiated the interests of those directors who had a "pecuniary interest in the transaction"[46] from the remaining directors who had no such direct interest but whose jobs would be more secure if the corporation neutralized Maremont's offer.[47] Since the directors claimed that Maremont's offer threatened corporate policy, the court in *Cheff*

39. *Id.* at 556.

40. DEL. CODE ANN. tit. 8, § 160 (2010).

41. *Cheff*, 199 A.2d at 554.

42. *Id.* (citing Bennett v. Propp, 187 A.2d 409, 409 (1962)).

43. *Id.* at 504-05 (citing Bennett v. Propp) (requiring directors to bear the burden of proving that their repurchase plan is in the corporation's best interest).

44. *Id.* at 554–55; *see also* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1290 (2001) ("Since 1985, a third category has more clearly emerged: cases where the directors have no direct pecuniary interest in the transaction but have an 'entrenchment' interest, i.e., an interest in protecting their existing control of the corporation."); *see* discussion *infra* Part II.A (discussing that enhanced business judgment is designed to monitor a motivational conflict).

45. *Cheff*, 199 A.2d at 554.

46. *Id.* at 554–55.

47. *Id.*

evaluated whether the "defendants satisfied the burden of proof of showing reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the Maremont stock ownership" and that "directors satisfy their burden by showing good faith and reasonable investigation."[48] Finding that the board met this burden, the Delaware Supreme Court in *Cheff* reversed the lower court, and upheld the board's actions.[49]

In *Unocal,* the Delaware Supreme Court built upon its *Cheff* analysis to create an enhanced standard of review for defensive tactics, which courts subsequently labeled the "enhanced" business judgment rule.[50] Although in *Cheff* the defensive tactic was an offer to purchase only the bidder's shares, and in *Unocal* the tactic was to purchase all shares except those of the bidder, the Delaware Supreme Court in *Unocal,* as it did in *Cheff,* first established statutory power for the board's decision to respond defensively by offering to repurchase corporate stock.[51] In so doing, however, the Delaware Supreme Court did not differentiate between the statute's grant of authority for repurchases in general, as opposed to repurchases as a defensive tactic. Instead, the Delaware Supreme Court embraced one key aspect of Mr. Lipton's position by agreeing that a board facing a tender offer has a duty to determine whether the offer is in the corporation's best interest: "In that respect a board's duty is no different from any other responsibility it shoulders, and its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment."[52]

48. *Id.* at 555.

49. *Id.* at 556–57.

50. *See Unocal*, 493 A.2d at 955 (going beyond the *Cheff* standard which required that directors prove that the tender offer threatened corporate policy); *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1376 n.17 (Del. 1995) (citing Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1154 (referring to *Unocal*'s two-part "enhanced business judgment rule").

51. The Delaware Supreme Court in *Unocal* found that the board had statutory authority for its conduct under title 8, section 141(a) of the Delaware Code, conferring management of the corporation's 'business and affairs' on the board, and under title 8, section 160(a) of the Delaware Code, which gives the board authority to deal in its own stock. *Unocal*, 493 A.2d at 953–54. *See also Cheff*, 199 A.2d at 554 (acknowledging that although the Delaware corporate statute gives the corporation the right to repurchase stock, the issue at hand was the directors' motivation for the repurchase). SEC rules subsequently invalidated the particular defensive tactic chosen in *Unocal. See* 17 C.F.R. §§ 240.14d-10, 240.13e-4(f) (requiring tender offers, including issuer repurchases, to be open equally to all holders of a class of securities).

52. *Unocal*, 493 A.2d at 954; Lipton, *supra* note 30, at 130; *see also Unocal*, 493 A.2d at 954 ("Finally, the board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source . . . . Thus, we are satisfied that in the broad context of

On the other hand, referring to *Cheff* and *Bennett*, the Delaware Supreme Court in *Unocal* then disagreed with Mr. Lipton's conclusion that the business judgment rule should apply, and instead pronounced a critical component of its position: "Because of the omnipresent specter that a board may be acting primarily in its own interests . . . there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred."[53] The Supreme Court in *Unocal* held that as is the case in all conflict transactions, the board must bear the burden of proof.[54] In deciding what the board would have to prove, the opaque words of the court in *Cheff* resurfaced; recall that the Delaware Supreme Court in *Cheff* had contended that the board's conflict differed from traditional conflicts, and therefore chose not to apply the entire fairness test.[55] In *Unocal*, the court of chancery disagreed with this aspect of *Cheff* and held that the board must prove that the chosen defensive tactic was fair to the corporation.[56] While the Delaware Supreme Court agreed that "directors are of necessity confronted with a conflict of interest,"[57] it disagreed with the standard of review chosen by the court of chancery, namely, the entire fairness test; instead, the Delaware Supreme Court cited to and amplified the *Cheff* test.[58]

In addition to *Cheff*'s requirement that the board must prove that the takeover was a danger to corporate policy and effectiveness,[59] the Delaware Supreme Court in *Unocal* added a second requirement, namely, that the board must prove that the defensive tactic was "reasonable in relation to the

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corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality.") (citation omitted); *Unocal*, 493 A.2d at 955 n.10 ("It has been suggested that a board's response to a takeover threat should be a passive one. However, that clearly is not the law of Delaware . . . .") (citation omitted).

53. *Id*. at 954. The court rejected, however, that directors have a conflict of interest simply because some board members own stock and would personally benefit from the proposed defensive tactic, which was an issuer repurchase at a premium. *Id.* at 957-58.

54. *Id.* at 952, 955 (noting that the chancery court had held that the board bears the burden of proof).

55. *See supra* text accompanying notes 44–47 (cautioning by court in *Cheff* that its decision to shift the burden to directors did not mean that it viewed the conflict at hand identically to conflicts directors face when they receive a pecuniary benefit).

56. Mesa Petroleum Co. v. Unocal Corp., No. 7997, 1985 WL 44691, at *4 (Del. Ch. May 13, 1985), *rev'd sub nom.,* 493 A.2d 946 (Del. 1985). *See* generally Bainbridge, *supra* note 9, at 799–800 (commenting on the relationship between *Cheff* and *Unocal*).

57. *Unocal,* 493 A.2d at 955.

58. *Id.* at 954–55; *see* Allen et al., *supra* note 44, at 1320 (articulating what became prong one of the *Unocal* test); *see infra* text accompanying notes 59-60 (building upon *Cheff*'s requirement that the board prove a danger to corporate policy by adding a second requirement, namely that the board must prove their tactic was reasonable in relation to the threat posed).

59. *Unocal*, 493 A.2d at 955.

threat posed."[60] This addition subsequently modified the aspect of *Unocal* that required courts to first evaluate whether the tactic is draconian before considering whether the tactic is a reasonable response.[61] If the board satisfies *Unocal*'s requirements, the business judgment rule applies.[62]

While the Delaware Supreme Court in *Unocal* held that it would apply the business judgment rule if the board passed the *Unocal* test, the court subsequently held in *Unitrin v. American General Corp.* that if the board failed *Unocal,* the board would then have to withstand the entire fairness test.[63] Presumably, the logic of *Unitrin* is that boards failing *Unocal* would have confirmed their conflict of interest, and, as a result, would now bear the burden of convincing the court that their conduct was nevertheless entirely fair. In reality, as it was at the beginning in *Unocal*, enhanced business judgment has remained the entire test. Of the five cases[64] post *Unitrin* that failed the *Unocal* test, Delaware courts mentioned in only one that defensive tactics that failed *Unocal* must then also undergo scrutiny

60. *Id.*

61. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387 (Del. 1995) ("An examination of the cases applying *Unocal* reveals a direct correlation between findings of proportionality or disproportionality and the judicial determination of whether a defensive response was draconian because it was either coercive or preclusive in character."). *See also In re* MONY Grp. S'holder Litig, 853 A.2d 661, 678 (Del. Ch. 2004) (explaining that "[t]he *Unocal* standard, as interpreted by *Unitrin* . . . first requires the court to determine if a defensive measure is preclusive or coercive. If so, it will be deemed draconian, and not protected by the presumptions of the business judgment rule. If it is not draconian, the defensive measure must be within a range of reasonableness, or proportional to an identified threat.") (internal citations omitted).

62. *Unocal,* 493 A.2d at 958. The court held that once the board passes the two *Unocal* requirements, then the business judgment rule applies unless the plaintiff shows, by a preponderance of the evidence, "that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or being uniformed . . . ." *Id.* Despite these options, it is virtually impossible for a plaintiff to satisfy any of these additional arguments. Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 327 (1987).

63. *Unitrin*, 651 A.2d at 1377 n.18 ("We note that the directors' failure to carry their initial burden under *Unocal* does not, *ipso facto*, invalidate the board's actions. Instead, once the Court of Chancery finds the business judgment rule does not apply, the burden remains on the directors to prove 'entire fairness.'").

64. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 936 (Del. 2003); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35-36 (Del. Ch. 2010); Aquila, Inc. v. Quanta Servs., Inc., 805 A.2d 196, 209 (Del. Ch. 2002); Chesapeake Corp. v. Shore, 771 A.2d 293, 317 (Del. Ch. 2000); Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 51-52 (Del. Ch. 1998), *aff'd sub nom.*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1292-93 (Del. 1998); *cf.* MM Companies, Inc. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003) (applying the *Blasius* test as a necessary component within the *Unocal* test and holding that board's failure of the *Blasius* test also constituted a failure of the *Unocal* test).

under the entire fairness test.[65] Courts in the other four cases that held that the defensive tactics failed *Unocal* simply proceeded to grant relief without any application of the entire fairness test.[66] The courts' disregard of the entire fairness test makes sense, however, because defendants cannot hope to prove their defensive tactic is fair after a court determines either under the first prong of *Unocal* that there was no threat to the corporation or under the second prong that the board's reaction was draconian or unreasonable. Phrased differently, having failed the weaker test of reasonableness, target directors cannot realistically hope to pass the more stringent test of fairness.

### *C. How Enhanced Is Enhanced Review?*

Before launching into what commentators and judges thought *Unocal* said, it is helpful to look carefully at the decision itself. Four aspects of *Unocal* indicate that despite the connotation behind "enhanced review," the court desired to limit its own involvement in reviewing board conduct. One was the court's refusal to employ the entire fairness test despite noting the directors' inherent conflict of interest.[67] The second related point is that instead of the searching inquiry entire fairness involves, the court clearly stated that the benchmark of its review would be a "reasonableness" review: did the board demonstrate reasonable grounds to believe there was a threat to corporate policy, did the directors show that they had conducted a reasonable investigation, and was their response reasonable in relation to

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65. *Chesapeake Corp*., 771 A.2d at 317 n.32 (Del. Ch. 2000) (stating that if defendants fail the *Unocal* test, they must prove their defensive tactics are entirely fair).

66. *See Omnicare, Inc.*, 818 A.2d at 935–36 (finding the deal-protection devices violated *Unocal* because the devices were both preclusive and coercive); *eBay Domestic Holdings, Inc.*, 16 A.3d at 34–35 (granting relief after finding that the board's decision to adopt a shareholder rights plan failed both prongs of the *Unocal* test without applying an entire fairness test); *Liquid Audio, Inc.*, 813 A.2d at 1131–32 (finding for the plaintiff and remanding to Court of Chancery after applying the *Blasius* "compelling justification" standard within the *Unocal* reasonableness analysis and finding that the directors failed to demonstrate a compelling justification for its decision to expand the board from five to seven members); *Aquila, Inc.*, 805 A.2d at 208 (finding that defendants could not meet their initial burden under *Unocal* because the defensive tactics they employed were not reasonable in relation to the threat posed to the corporation but denying plaintiffs preliminary injunction motion on other grounds); *Quickturn Design Sys., Inc.*, 721 A.2d at 1291–93 (affirming the chancery court's decision that the defendant's deferred redemption plan was unenforceable on the alternative grounds that the plan "impermissibly circumscribe[d]" the board's power under § 141(a)).

67. *See supra* note 26 (explaining that entire fairness review is searching and requires heavy judicial involvement); *see supra* text at notes 57-58 (refusing to apply the entire fairness test as the chancery court had done).

the threat posed.[68] Third, the court indicated that it would afford substantial deference to independent directors,[69] thereby indicating that it was not looking to review business decisions carefully. The final aspect was its reasoning that the shareholder vote, not the court, should provide the ultimate monitor of board conduct: "If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out."[70] The court's admonition that shareholders are the final arbiter of their board's conduct implied that the court believed most defensive tactics would not constitute a breach of the directors' fiduciary duties; thus, if shareholders objected to defensive tactics, they would have to vote for different directors. In sum, the court's refusal to adopt entire fairness review, its emphasis on reasonableness, its stated deference to independent directors, and its admonition that shareholders ultimately possess the tools to reign in their directors all convey that the Delaware Supreme Court in *Unocal* was not looking to provide a level of review that required heavy judicial involvement.

In addition, the court's choice of language in *Unocal* strongly suggests that it intended for its review to provide the board substantial latitude, rather than substantial judicial review. At the outset, "enhanced business judgment" creates an association to the deference that is the hallmark of the business judgment rule. Although some would disagree with Professor Velasco's conclusion about whether deference was a fatal flaw in the new standard of review, his observation that deference linked enhanced business judgment to the business judgment rule is apt: "By tying the test so closely to the business judgment rule, the court doomed *Unocal* to be of limited significance . . . . [T]he deference of the business judgment rule . . . was the downfall of the *Unocal* standard."[71] The Delaware Supreme Court's other

68. *Unitrin*, 651 A.2d at 1385–86 ("[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. . . . Thus, courts . . . will determine if the directors' decision was, on balance, within a range of reasonableness.") (emphasis omitted); *see* Palm & Kearney, *supra* note 27, at 1051 (reasoning that *Unocal* required the board to show their tactics were reasonable).

69. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) ("Furthermore, such proof is materially enhanced, as here, by the approval of a board comprised of a majority of outside independent directors who have acted in accordance with the foregoing standards.").

70. *Id.* at 959. Thus, Delaware courts have committed to ensuring that defensive tactics do not preclude the shareholder vote. *See Unitrin*, 651 A.2d at 1385 (remanding to the chancery court to determine whether the defendant board took unreasonable steps to preclude the shareholder franchise); Martin Lipton & Paul K. Rowe, *Pills, Polls, and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1, 33 (2002) (commenting on the value that Delaware places on shareholder voting).

71. Velasco, *supra* note 10, at 884.

word choices, such as its directive that boards could not use "draconian" tactics,[72] put the vast array of non-draconian defensive tactics in play, limited thereafter only by whether the tactic was within the range of reasonable responses.[73] Similarly, adding a "further caveat that inequitable action may not be taken under the guise of law"[74] reinforced that the court would not tolerate defensive tactics whose function was solely to perpetuate the directors in office;[75] other defensive tactics, within a wide range of what is considered "reasonable," however, would be acceptable. Thus, by using highly-charged words like "inequitable" and "draconian," the court identified that the line of impermissible tactics would be quite distant. In essence, the Delaware Supreme Court in *Unocal* did not intend for the new standard to be half-way between business judgment and entire fairness review. It is telling that the words "intermediate review," or anything similar, are simply not found anywhere in *Unocal.* In fact, one year after the Delaware Supreme Court decided *Unocal*, its court of chancery was the first to label *Unocal* review as an "intermediate form of judicial review;"[76] the Delaware Supreme Court did not itself label enhanced review as intermediate until eleven years after it decided *Unocal*.[77]

Regardless of the level of scrutiny the court thought it had created in this new standard of review, commentators and jurists had different views of the extent and rigor of *Unocal* review. Some commentators concluded that Unocal's enhanced review had achieved a correct balance of competing interests[78] but conceded that this review was not rigorous.[79] In

72. *Unocal,* 493 A.2d at 955.

73. *Cf.* Velasco, *supra* note 10, at 848 (contending that non-draconian responses are likely reasonable); *see also infra* discussion Part III.A (proposing a reformulation of enhanced business judgment).

74. *Unocal,* 493 A.2d at 955.

75. *Id.*

76. AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986); *cf.* Bainbridge, *supra* note 9, at 800 (viewing enhanced review as lying between the duties of care and loyalty, rather than between the business judgment rule and entire fairness).

77. Williams v. Geier, 671 A.2d 1368, 1377 n.18 (Del. 1996) (reasoning that *Unocal* jurisprudence requires the board's actions to "pass an intermediate level of enhanced judicial scrutiny" before the business judgment rule can apply).

78. Allen et al., *supra* note 44, at 1319 ("*Unocal*'s original rationale for crating the intermediate standard of review was sound. That intermediate standard operates at the intersection between the directors' authority to manage the corporation and the stockholders' rights and powers as owners of property. Where directors take actions that impede the ability of the owners of the enterprise to sell their shares or elect a new board of directors . . . it [is] appropriate to employ a more searching and flexible form of judicial review to assess the validity of the board's action."); Bainbridge, *supra* note 9, at 862–63 ("The board has legitimate authority in the takeover context, just as it has in proxy contests

contrast to commentators who argued that *Unocal* review was in need of sharper teeth to better protect shareholders, these commentators viewed the mild nature of *Unocal* review as appropriate because it afforded directors the deference necessary to effectively operate a company.[80] Only a few who hailed *Unocal* review for simultaneously allowing boards leeway to act subject to some judicial review thought that review was intermediate;[81] however, some of these commentators have questioned whether *Unocal* review actually continues to be an intermediate level of scrutiny after several subsequent decisions arguably diluted *Unocal* review.[82]

In contrast, the *Unocal* doctrine disappointed others who contended that enhanced business judgment review provided insufficient monitoring because the review was more form than substance: although the board now bore the burden of proof, what it had to prove was easily satisfied.[83] This

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and a host of other decisions that nominally appear to belong to the shareholders. . . . Therefore, authority cannot be avoided anymore than accountability; the task is to come up with a reasonable balance. Properly interpreted, that is precisely what the Delaware cases have done.").

79. Professor Bainbridge concluded his article by arguing that the Delaware courts have settled on a "reasonable balance" between authority and accountability with the *Unocal* standard of review. *See* Bainbridge, *supra* note 9, at 862–63; Bainbridge, *supra* note 9, at 800 ("[T]he Unocal test is more properly seen as a conditional version of the business judgment rule, rather than an intermediate standard of review lying between the duties of care and of loyalty.").

80. Bainbridge*, supra* note 9, at 800.

81. *See* Allen et al., *supra* note 44, at 1319 ("*Unocal*'s original rationale for creating the intermediate standard of review was sound. . . . Where directors take actions that impede the ability of the owners of the enterprise to sell their shares or elect a new board of directors . . . it [is] appropriate to employ a more searching and flexible form of judicial review to assess the validity of the board's action."); Bradley R. Aronstam, *The Interplay of Blasius and Unocal—A Compelling Problem Justifying the Call for Substantial Change*, 81 OR. L. REV. 429, 470-71 (2002) (arguing that enhanced business judgment is an intermediate standard of review); Terry M. Hackett*, Paramount Communications, Inc. v. Time Inc.: Taking the Teeth Out of Proportionality Review*, 22 LOY. U. CHI. L.J. 229, 243 (1990) (noting that "the [*Unocal*] standard is truly intermediate and provides an effective way for the court to distinguish takeover defenses that are beneficial to shareholders from those designed to entrench incumbent management" but arguing that the court's decision in *Paramount* weakened *Unocal*).

82. *See, e.g.*, Allen et al., *supra* note 44, at 1315-16 n.111 (explaining that the court diluted the *Unocal* test when it held in *Paramount* that a board may defend against shareholders' opposing an unsolicited bid); Aronstam, *supra* note 81, at 470 (asserting the Delaware Supreme Court diluted the effectiveness of *Unocal* review). *See infra* text accompanying notes 177-196 (discussing the cases that have arguably diluted *Unocal*, namely, *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989) and *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995)).

83. *See* Johnson & Siegel, *supra* note 62, at 338 (arguing that "*Unocal*'s loyalty tests are superficial. The only substantive aspect of the *Unocal* test is that the directors fulfill their duty of care, and that standard is easily met . . . ."); see also Eric A. Chiappinelli, *The Life and Adventures of Unocal - Part I: Moore the Marrier*, 23 DEL. J. CORP. L. 85, 89, 143

argument was based on the logic that since virtually all tender offers seek to change corporate policy, *Unocal*'s first step was easily met, and *Unocal*'s second step requiring a reasonable response would weed out only the most extreme defensive tactics. Phrased differently, *Unocal* allows the vast majority of defensive tactics to be implemented.[84] Furthermore, some commentators reasoned that two additional aspects of *Unocal* further diluted enhanced business judgment's already weak prongs. One was the court's proffer of deference to decisions made by a board consisting of a majority of independent directors;[85] to no one's surprise, boards changed their composition to earn this deference even before federal law and stock exchanges mandated that a majority of boards of public corporations consist of a majority of independent directors.[86] The second was the court's statement that in satisfying each step, the board could consider the interests of constituencies other than shareholders.[87] For example, permitting the board to consider the interests of non-shareholder constituencies freed the directors to consider whether a bidder's plans included firing corporate employees.[88] In so doing, the court fortified the

(1998) (noting that *Unocal* placed the burden of proof on the board, and concluding that, over time, the *Unocal* test was created, debated, and turned into the equivalent of the business judgment rule); Scott P. Towers, *Ivanhoe Partners v. Newmont Mining Corp. - The Unocal Standard: More Bark Than Bite?*, 15 DEL. J. CORP. L. 483, 485 (1990) ("[W]hile the Delaware Supreme Court may have altered its standard for reviewing directors' actions in response to takeover attempts, the alteration detracts little, if any, from the protections of the business judgment rule.").

84. Johnson & Siegel, *supra* note 62, at 338 (arguing that most defensive tactics will pass *Unocal*'s standard of review).

85. *Unocal,* 493 A.2d 946, 955 (Del. 1985).

86. STANDARDS RELATING TO LISTED COMPANY AUDIT COMMITTEES, EXCHANGE ACT (as added by Sarbanes-Oxley Act of 2002 § 301) Release Nos. 33-8220, 34-47654, 68 Fed. Reg. 18,788 (Apr. 16, 2003), *available at* http:// www.sec.gov/rules/final/33-8220.htm; SECURITIES AND EXCHANGE COMMISSION, NASD AND NYSE RULEMAKING: RELATING TO CORPORATE GOVERNANCE, Release No. 34-48745 (Nov. 4, 2003) *available at* http://www.sec.gov/rules/sro/34-48745.htm#P58_18388 (approving New York Stock Exchange and Nasdaq listing requirements that require the board of directors of each listed company to consist of a majority of independent directors). Of the thirty-seven cases that have passed *Unocal*, thirty-one had boards with a majority of independent directors, two did not, and courts in four cases did not provide this information. Siegel, *supra* note 13, at 621.

87. *Unocal*, 493 A.2d at 955 (noting that in evaluating a reasonable response to the threat, the board may consider the bid's "effect on the corporate enterprise" and that "[e]xamples of such concerns may include . . . the impact on 'constituencies' other than the shareholders"). *Revlon* subsequently modified this requirement. *See infra* note 89 and accompanying text.

88. *Unocal*, 493 A.2d at 955. By so holding, the court made it easier for the target board to satisfy step one, because hostile offers often are a threat to target employees who may lose their jobs if the offeror succeeds and restructures the target. *See* DOOLEY, *supra* note 33 (explaining that interests of other constituencies may align more with management than with shareholders); Bainbridge, *supra* note 9, at 773 n.23. Directors also benefit in step

board's success rate in identifying a threat as well as the range of reasonable responses to that threat. Subsequently, the Delaware Supreme Court reformulated the board's ability to consider non-shareholder constituencies by adding that target directors could consider these constituencies only if there are "rationally-related benefits accruing to the stockholders."[89] The court's reformulation, however, only alerted boards to the court's view that all constituencies did not have equal priorities.

This perspective of a fairly passive *Unocal* review is borne out by statistics. Cases subsequent to *Unocal* have proven *Unocal*'s critics to be largely correct in their claim that *Unocal* review is fairly benign. The criticism that *Unocal*'s first requirement was toothless and would be easily met is proven by the fact that in *Unocal*'s twenty-seven year history, only one case has failed this first prong and that was because the court found that the board's stated policy was invalid;[90] as such, the court did not have to reach the issue of whether the board had properly identified a threat. Moreover, although whoever has the burden of proof is supposed to be more likely to lose its case,[91] defendant directors have passed the enhanced business judgment test in seventy-nine percent of *Unocal* cases.[92] Nothing

two from the ability to consider other constituencies because more tactics will be deemed reasonable to protect the broader base of constituencies. Id.

89. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986). *Revlon* further held that when a board is in a *Revlon* mode, rather than in a *Unocal* mode, the board may not consider the interests of non-shareholder constituencies. *Id. Contra* IND. CODE § 23-1-35-1(d) (2009) (allowing board to consider interests of non-shareholder constituencies in all transactions).

90. Siegel, *supra* note 13, at 620 (identifying *eBay* as the only case to fail *Unocal*'s first prong); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010) ("Thus, I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders . . . .").

91. *See, e.g.*, Stephen Ferrey, *The Toxic Time Bomb: Municipal Liability for the Cleanup of Hazardous Waste*, 57 GEO. WASH. L. REV. 197, 277 (1988) (contending that "[w]hichever side . . . ultimately inherits the final burden of proof is likely to lose in any legal confrontation"); Janene R. Finley & Allan Karnes, *An Empirical Study of the Change in the Burden of Proof in the United States Tax Court*, 6 PITT. TAX REV. 61, 66 (2008) ("If all things are equal in a case, the party who would win is the one who does not have the burden of proof."); David McGowan, *Copyright Nonconsequentialism*, 69 MO. L. REV. 1, 2 (2004) ("[T]he legal endgame is to place the burden of proof on the other side. Whoever has to prove the unprovable facts is likely to lose.").

92. For a list of cases that failed *Unocal*, see Siegel, *supra* note 13, at 619–21 n.96. *See also* Kallick v. Sandridge Energy, Inc., 68 A.3d 242, 258 (Del. Ch. 2013) (finding directors failed *Unocal* by refusing to consider a slate of new directors and falsely informing shareholders that the election of the rival board would trigger a "Proxy Put" provision forcing the company to repurchase $4.3 billion of debt). Similarly, the Delaware Supreme Court extended enhanced business judgment review to *Revlon* decisions, where defendants enjoy an identical 79% success rate as well; *see infra* Part II.B (discussing the Delaware

can explain this simultaneous high success rate and shouldering the burden of proof other than acknowledging that what defendants have to prove under this standard of review is not difficult. As such, labeling the *Unocal* test as an intermediate standard of review must be understood as meaning only that this test is not quite as deferential as is the business judgment rule; enhanced business judgment simply cannot be understood as approaching any intermediate or half-way mark between the business judgment rule and entire fairness.[93] Thus, one must embrace cautiously statements like the one the chancery court articulated in *In re Dollar Thrifty* describing enhanced business judgment as being "[i]n that middle ground, the reviewing court has leeway to examine the reasonableness of the board's actions under a standard that is more stringent than business judgment review and yet less severe than the entire fairness standard."[94]

Other jurists agree that *Unocal* review has little bite. Chief Justice Strine, in both his earlier scholarly writing and in some of his cases, has acknowledged that enhanced business judgment has fallen short. For example, in *Mercier v. Inter-Tel (Delaware), Inc.,*[95] then Vice-Chancellor Strine stated, "I recognize . . . that some of the prior *Unocal* case law gave reason to fear that that standard, and the related *Revlon* standard, were being denuded into simply another name for business judgment rule review."[96] Additionally, Chancellor Strine and several other judges wrote an article in which they conceded that "*Unocal*, with its enhanced business judgment language proved to be rather management friendly . . . ."[97]

Another jurist, Chancellor Chandler, has a slightly different view: he contends that *Unocal* was, at its origins, more of a meaningful standard of review, but subsequent Delaware Supreme Court decisions diluted that review to its current anemic state. In *Air Products and Chemicals v. Airgas, Inc.*,[98] Chancellor Chandler regarded two Delaware Supreme Court decisions, *Paramount Communications v. Time*,[99] and *Unitrin, Inc. v.*

Supreme Court's *Revlon* decision).

93. *See* Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1124 (Del. Ch. 1990) ("*Unocal* establishes an intermediate form of judicial review that when applicable introduces into business judgment discourse elements of the fiduciary duty analysis); *see also* Bainbridge, *supra* note 9, at 800 (arguing that the *Unocal* standard is not truly intermediate, but rather "a conditional version of the business judgment rule"); Kristin A. Linsley*, Statutory Limitations on Directors' Liability in Delaware: A New Look at Conflicts of Interest and the Business Judgment Rule*, 24 HARV. J. ON LEGIS. 527, 545 (1987) (describing the *Unocal* standard as a "modified business judgment analysis").

94. *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598 (Del. Ch. 2010).

95. 929 A.2d 786 (Del. Ch. 2007).

96. *Id.* at 810. (footnote omitted)

97. Allen et al., *supra* note 44, at 1315. (footnote omitted)

98. 16 A.3d 48 (Del. Ch. 2011).

99. 571 A.2d 1140 (Del. 1990).

*American General Corp.*,[100] as game-changers because, among other controversial aspects of those cases,[101] the Delaware Supreme Court criticized in dictum the strong *Unocal* review performed by the respective chancery court judges.[102] Thus, in *Air Products,* Chancellor Chandler lamented the dilution of *Unocal* review, and held that *Unitrin* and *Paramount* compelled him to permit the target board to keep its poison pill in place, despite his personal view that the pill served no further role in the facts before him.[103]

Whether Chancellor Chandler is correct that *Unocal* originally was truly intermediate review that subsequent Delaware Supreme Court decisions have weakened,[104] or whether, as argued above,[105] the Delaware Supreme Court never intended enhanced review to provide strong intermediate review, is now academic.[106] Instead, enhanced business judgment allows the board to act within extremely broad parameters. Rather than engaging in searching scrutiny of the board's conduct, the court has instead chosen to play border guard. The court uses enhanced business judgment only to ensure that directors neither act unreasonably[107] nor preclude the shareholder vote so that shareholders have the option to

100. 651 A.2d 1361 (Del. 1995).

101. *See infra* Part III.A (discussing controversial aspects of *Time* and *Unitrin* and their impact on enhanced business judgment review).

102. *See* Unitrin Inc. v. Am. Gen. Corp., 651 A.2d at 1361, 1389–90 (Del. 1995) (chiding the chancery court for determining that a defensive tactic was unnecessary, a determination that belongs to directors, not to the court); Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989) (noting that to the extent the chancery court in recent decisions substituted its judgment for that of the board, such substitutions would be inconsistent with *Unocal*).

103. In *Air Products*, Chancellor Chandler reluctantly held that the Delaware Supreme Court permits corporations to keep poison pills in place indefinitely, even though Chancellor Chandler contended that Airgas' poison pill had already served its purpose of generating a higher bid from the offeror and time to communicate its views to its shareholders. Air Prods. & Chems. v. Airgas Inc., 16 A.3d 48, 57–58 (Del. Ch. 2011).

104. Chancellor Chandler's view that *Unocal* originally provided intermediate review stems not from *Unocal* itself, but instead from *Moran v. Household International, Inc.*, which allowed corporations to adopt a poison pill but cautioned that the pill could not stay in place forever. *Id*. at 95-96.

105. *Supra* notes 67-75 and accompanying text.

106. *See, e.g.*, Mark J. Loewenstein, *Unocal Revisited: No Tiger in the Tank*, 27 J. CORP. L. 1, 2 (2001) ("Delaware jurisprudence since *Unocal* reveals that, despite the promise articulated in that case . . . the Delaware Supreme Court has been reluctant to interfere with board decisions . . . ."); Velasco, *supra* note 10, at 847 (contending that "the enhanced scrutiny standard sound[s] strikingly similar to the business judgment rule"); *id*. at 884 ("*Unocal* . . . sounded promising at first and later proved to be relatively ineffectual.").

107. Koehler v. NetSpend Holdings, Inc., No. 8373-VCG, 2013 WL 2181518, at *11 (Del. Ch. 2013) ("Enhanced scrutiny . . . is a test of reasonableness . . . .") (citing *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 595-96 (Del. Ch. 2010)).

vote out of office the directors who engage in defensive tactics.[108] Given that Delaware courts have always protected the shareholder vote,[109] shareholders gained little ground in that aspect of enhanced review.[110]

These observations bring us full circle. The Delaware Supreme Court's concession in both *Cheff* and *Unocal* that target directors face some type of conflict of interest eliminated the business judgment rule as a credible standard of review. The court, however, neither applied the entire fairness test nor explained why it bypassed that test. The import of these decisions is significant: *Unocal*'s creation of the enhanced business judgment standard of review gave the court the freedom it lacked under the business judgment rule to review the reasonableness of the board's reaction to a hostile offer, while not requiring the court to determine if the board's reaction is entirely fair.[111] Part II of this Article examines the issue the court left unspoken in *Cheff* and *Unocal*: the nature of the conflict that caused the court to eschew both the business judgment standard and the entire fairness standard. Part II will also consider whether the courts' extension of enhanced business judgment to *Revlon* and a voting case is consistent with that conflict.

## II. ENHANCED BUSINESS JUDGMENT: THE UNDERBELLY AND ITS TENTACLES

### *A. The Underbelly: What Kind of Conflict Is Enhanced Business Judgment Designed to Monitor?*

As discussed above,[112] the Delaware Supreme Court faced competing views on how to deal with directors' desire to enact defensive tactics. Those favoring giving directors nearly unfettered discretion argued that the

108. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").

109. MM Companies, Inc., v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) (characterizing the shareholder franchise as "the 'ideological underpinning' upon which the legitimacy of directors managerial power rests.") (footnote omitted); Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1193 (Del. Ch. 1998) (citing the "primacy of the shareholder vote" in Delaware's system of corporate governance); Blasius Indus. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (describing the shareholder vote as of "central importance . . . to the scheme of corporate governance. . . .").

110. *See* Paul L. Regan, *What's Left of Unocal?*, 26 DEL. J. CORP. L. 947, 970 (2001) (arguing that *Unocal* review "has, as a practical matter, been reduced to the . . . task of ensuring that the shareholders retain the ability to remove their board of directors through the proxy machinery.").

111. STEPHEN M. BAINBRIDGE, MERGERS AND ACQUISITIONS 277 (3rd ed. 2012).

112. *See supra* notes 30–36 and accompanying text.

business judgment rule applied. Those who believed that directors had an inherent conflict of interest claimed (among other arguments) that the board should be required to remain passive in the face of a hostile offer, or at least should have to prove the entire fairness of any defensive tactic—a standard that the board would fail in most cases. Implicit in these competing views lies a further divide: those who favored the business judgment rule necessarily believed that directors face no conflict of interest in this context,[113] while those who favored passivity or entire fairness believed the board has an inherent conflict of interest. Seemingly, the Delaware Supreme Court chose a path between these views. As an acknowledgment to those who thought there was a conflict of interest, the court required the board to bear the burden of proof; as an acknowledgment to those who thought the business judgment rule should apply, the court imposed only a light burden on the board. As a result, the court would neither defer to the board's decision nor scrutinize it carefully under the enhanced business judgment rule.

The court's creation of a middle ground might have been more than simply an effort to appease both sides in the debate. In fact, the court would likely have reached its conclusion even without the boundaries being so carefully demarcated. The reason is that enactment of defensive tactics itself occupies the middle ground between an obvious conflict—as is the case when directors transact business with their corporation—and a suspicion that a conflict could exist by virtue of the directors concern about losing their jobs should a hostile offer succeed.[114] As the court in *City Capital Associates v. Interco, Inc.* reasoned, the enactment of defensive tactics is "neither self-dealing nor wholly disinterested."[115] Instead of facing a conflict based on a concrete, financial interest, target directors faced a motivational conflict: are directors motivated to act in the corporation's best interest, or are directors instead motivated by preserving

113. *Cf.* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (stating that among other requirements for application of the business judgment rule, directors must be disinterested).

114. *See, e.g.*, Allen et al., *supra* note 44, at 1290 (differentiating between "situations involving self-dealing . . . by requiring the directors to justify as intrinsically fair any transaction in which they had a financial interest [from]. . . cases where the directors have no direct pecuniary interest in the transaction but have an 'entrenchment' interest, i.e., an interest in protecting their existing control of the corporation."); Judd F. Sneirson, *Merger Agreements, Termination Fees, and the Contract-Corporate Tension*, 2002 COLUM. BUS. L. REV. 573, 589 (2002) ("Where a board is faced with a bid to take over the company, and acts to defend the company against it, circumstances present a conflict of interest, although not the sort of conflict of interest implicated in traditional duty of loyalty settings. Although directors may not have a direct personal or pecuniary stake in the decisions they make, they naturally have an interest in remaining in control of the company, remaining in office, and enjoying the perquisites of office.") (footnote omitted).

115. 551 A.2d 787, 796 (Del. Ch. 1988).

their jobs? Thus, it is necessary to explain what the court did not: the nature of a motivational conflict and how this conflict differs from traditional conflicts where a director's self-interest is pecuniary and visible.[116] This Article uses the term "conflict-lite" synonymously with a motivational conflict.

In *Aronson v. Lewis*, the Delaware Supreme Court offered two definitions of "interested" transactions: one, if directors "appear on both sides of a transaction"[117] or two, if directors "expect to derive any personal financial benefit from it in the sense of self-dealing."[118] Since self-dealing involves a director standing on both sides of a transaction, these two definitions overlap considerably, with the second reinforcing that the conflict must be financial in nature. It is therefore not surprising that one aspect of the entire fairness test directly responds to concerns about self-dealing by requiring the interested directors to show that they dealt fairly.[119] Similarly, while the fair dealing component of the entire fairness test could easily encompass the element of fair price, the court has reinforced the financial aspect of a conflict by making fair price an independent prong of the entire fairness test.[120]

In contrast, a situation such as responding to a hostile tender offer will generate a motivational conflict, causing shareholders to question why the directors acted as they did. In a hostile offer context, directors can support, remain neutral, or attempt to fend off the offeror. Those management decisions bear directly on whether the directors retain their positions. Therefore, a cloud of suspicion envelops the directors' chosen response to a hostile offer.

While there are myriad reasons that the Delaware Supreme Court might shun entire-fairness review of defensive tactics,[121] if it had wanted to

116. *See* Sneirson, *supra* note 114, at 589 (describing the conflict of interest target directors face in a hostile tender offer).

117. *Aronson*, 473 A.2d at 812.

118. *Id.*

119. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (noting that the entire fairness test encompasses not just a fair price, but also fair dealing, which "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.").

120. *Id.* (defining entire fairness as encompassing fair dealing and fair price).

121. Professor Gilson aptly made the point that the entire fairness standard in this context would have put the court in a situation that was anathema to the court:

> Applying a fairness standard to this decision, however, requires a court to determine whether it was 'fair' for control to remain with management rather than shift to the offeror. And this inquiry must necessarily focus on whether the shareholders would be better off with existing management or by selling their shares.

pursue this route doing so would have been pointless. The entire-fairness test is simply inapt because defensive tactics cannot be measured by either the fair dealing or the fair price component of this test: target directors are not dealing with the corporation at all,[122] and securing a fair price for its defensive tactic is not the issue.[123] Thus, the question that needed answering—are the directors motivated to act in the best interest of the corporation when they enact defensive tactics—is different from traditional conflicts not only in degree but also in kind, and, as such, *required* a new paradigm. As a result, this different type of conflict necessitated different monitoring.

One caveat before moving on to examine the enhanced business judgment monitor: some might question whether this motivational conflict is simply the same as structural bias, another concept that intermittently surfaces in the Delaware case law.[124] As Professor Velasco explained:

> The term 'structural bias' generally refers to the prejudice that members of the board of directors may have in favor of one another and of management. It is said to be the result of the 'common cultural bond' and 'natural empathy and collegiality' shared by most directors, the 'economic[] or psychological[] dependen[cy] upon or tie[s] to the corporation's executives, particularly its chief executive,' and the 'process of director selection and socialization, which incumbent management dominates.'[125]

The two concepts, conflict-lite and structural bias, share a core feature in that both constitute a conflict not involving financial self-dealing. Despite this common feature, the two concepts are fundamentally different. Structural bias encompasses a variety of reasons that might prejudice directors to act *in favor* of each other, rather than in the best interest of the

Gilson, *supra* note 32, at 827.

122. *Cf. Weinberger*, 457 A.2d at 710 (noting that fair dealing addresses concerns raised when directors sit on both sides of a transaction, thus implying that such a test is inapt when directors are not on both sides of a transaction).

123. *See* Gilson, *supra* note 32, at 827 (explaining that whether a fair price was paid for a defensive measure is irrelevant because the potential conflict at interest involves the decision to block a change in control, not any decision related to price).

124. The Delaware Supreme Court has raised the issue of structural bias in derivative actions. *See* Beam v. Stewart, 845 A.2d 1040, 1050-51 (Del. 2004) (discussing structural bias including the development of close "personal friendship[s]"); Velasco, *supra* note 10, at 821, 849 (reviewing *Aronson v. Lewis*' discussion of structural bias and contending that *Zapata*'s recognition of "the realities of [the] situation" of the likely recommendation of a board's special litigation committee are "simply another articulation of structural bias.").

125. Velasco, *supra* note 10, at 824 (citations omitted).

corporation:

> First, structural bias can be understood as a form of implicit conspiracy: directors may pursue their group interests consciously, even in situations where there is no obvious personal benefit. Second, structural bias may be understood as the effect of relationships: directors may favor friends and colleagues over distant shareholders. Third, structural bias may be understood as a psychological phenomenon: a manifestation of in group bias, which may operate on an unconscious level.[126]

In contrast, conflict-lite is limited to a specific economic *self-interest* where directors' motivation to save their jobs might consciously or unconsciously collide with their fiduciary duty to act in the best interest of the corporation and its shareholders.[127]

At least in theory, the Delaware Supreme Court should have designed the enhanced business judgment monitor to identify whether target directors were acting to protect the corporation or were instead acting to protect their jobs in violation of their fiduciary duty of loyalty.[128] Unfortunately, neither of *Unocal*'s two prongs elicits the directors' motive. The shareholders' claim that the board violated its duty of loyalty by acting to protect the board members' jobs generated only an inferential response: if there is a threat to corporate policy as *Unocal'*s first prong requires, the court will assume that threat, rather than directors seeking to protect their own jobs, must be the reason the board enacted defensive tactics. If *Unocal*'s critics are right that directors can always find a threat to corporate policy,[129] this inference is hollow. As noted above,[130] *Unocal*'s long history reinforces this criticism. Only one case has ever failed *Unocal*'s first

126. *Id.* at 855.

127. *Cf. Id.* at 846–47 (claiming *Unocal*'s "omnipresent specter" is simply another name for structural bias, and amplifying that "[a]lthough the court did not see the [*Unocal*] case as involving self-dealing, it understood that directors were conflicted. This is the essential claim of structural bias.").

128. *See* Leo E. Strine, Jr. et. al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 671 (2010) (stating that the *Unocal* test is about discerning the board's motives). *But see* Steven G. Bradbury, *Corporate Auctions and Directors' Fiduciary Duties: A Third-Generation Business Judgment Rule*, 87 MICH. L. REV. 276, 301 (1988) (stating that *Unocal* disregards the board's subjective motives and looks only at the tactics themselves).

129. *See supra* note 90 and accompanying text (stating that only one case had ever failed to prove the tender offer was a threat to corporate policy, and that was only because the corporation tried to protect an invalid policy).

130. *See supra* note 90 and accompanying text (explaining that only one case has failed the first prong of *Unocal)*.

prong,[131] and that failure occurred because the board's policy was invalid,[132] not because there was no danger. Little need be said about the viability of a test that one party passes virtually 100% of the time. Perhaps the ineffectiveness of *Unocal's* first prong was inevitable, as the courts' prior attempts to discern a board's "true" motive in other contexts have been similarly ineffective.[133]

If the search for a board's true motive is merely a quixotic inquiry, and if target directors can always show a threat to corporate policy, one must hunt further to find a function for *Unocal*'s first prong. Prong one seems to function solely to tee up the court's concern about the board's motivation. This concern thereafter provides the justification for the court, in prong two, to examine the board's decision, rather than defer to the directors' business judgment.

As such, the heart of enhanced business judgment is its second prong. Having stated that the board has an inherent conflict that makes evaluation under the business judgment rule inapt*,* the court chose to evaluate whether the board's response was within a range of reasonableness. The logic behind this prong is that the court would not have to isolate whether and to what extent the board's conflict impacted on the decision as long as there was another plausible scenario: a threat to the corporate policy existed (prong one) and the board responded reasonably to that threat (prong two). Viewed another way, *Unocal*'s second prong enabled the court to evaluate whether or not target directors were inflicting harm on the corporation,

131. eBay Domestic Holdings, v. Newmark, 16 A.3d 1 (Del. Ch. 2010).

132. *Id.* at 34-35 (ruling that Craigslist's policy designed to aid communities by providing free classified ads is "devoid of monetized elements" and therefore was an invalid corporate policy for a for-profit corporation).

133. *See, e.g.*, Sinclair Oil Corp. v. Levien*,* 280 A.2d 717, 721-22 (Del. 1971) (examining the board's motive for declaring dividends by asking the futile question of whether all shareholders got their pro rata share); *In re* RJR Nabisco, Inc. S'holders Litig., No. 10389 1989 WL 7036, at *10 (Del. Ch. Jan. 31, 1989) (examining the board's motivation to grant the winning bid to an outside bidder rather than management's bid by looking at the reasonableness of the board's decision); *see also*, Bernard Black & Reinieer Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 NW. U. L. REV. 521, 565 (2002) (positing that the court should look at the effect of the board's actions because of the difficulty of determining the directors' primary motive); *cf.* Joshua L. Vineyard, *Let (Corporate) Freedom Ring: Reaffirming the Importance of the Shareholder Franchise in State of Wisconsin Investment Board v. Peerless Systems Corporation*, 71 U. CIN. L. REV. 1443, 1465–66 (2003) (noting that requiring courts to identify a board's primary purpose is one of the reasons the *Blasius* test has been invoked infrequently). *But cf.* Mercier v. Inter-Tel (Delaware), Inc., 929 A.2d 786, 807 (Del. Ch. 2007) (describing the *Unocal* test and concluding, "[b]ecause there is a burden on the party in power to identify its legitimate objectives and to explain its actions as necessary to advance those objections, flimsy pretense stands a greater chance of being revealed.").

regardless of their motives.[134] While target shareholders may object to allowing directors' motives to be self-serving as long as the board selects a reasonable defensive tactic, the Delaware Supreme Court evaluated what it could: tangible harm to the corporation. Subsequently, the court made this same tradeoff—abandoning the elusive search for motive and instead evaluating tangible harm to the corporation—when it applied enhanced business judgment in *Revlon*.[135]

In sum, the Delaware Supreme Court in *Cheff* explained its theory of director conflicts by a negative example, reasoning that its decision to shift the burden did not indicate that "the directors have the same 'self-dealing interest' as is present, for example, when a director sells his property to the corporation."[136] This negative explanation left future courts to guess at the difference between traditional conflicts and defensive tactic conflicts. This Article has now isolated what the court did not: the *Unocal* conflict is one of motive. Since identifying an inherently conflicted motive is challenging, *Unocal's* second prong elevates the court's evaluation of whether the board's response was reasonable to the test's defining point.

### *B. The Reach of the Tentacles—So Far*

Thus far, the Delaware Supreme Court has extended enhanced business judgment only to the *Revlon* context.[137] In addition, one court of

134. BAINBRIDGE, *supra* note 111, at 277 (noting that the directors' motive is really irrelevant; as long as the directors did not cause harm to the corporation, the court acted under the "no harm no foul theory").

135. *See infra* Part II.B (discussing the Delaware Supreme Court's *Revlon* decision).

136. Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964).

137. Delaware courts have thus far stated that only a few fact patterns will put a corporation in a "*Revlon* mode." *In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995) (listing the following transactions that will put the corporation in a *Revlon* mode: "(1) when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company; (2) where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company; or (3) when approval of a transaction results in a sale or change of control") (quoting Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1290 (Del. 1994)) (citations and internal quotation marks omitted); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1989) (applying enhanced business judgment when the corporation is in a *Revlon* mode). Since the Delaware Supreme Court has yet to draw a clear line for when *Revlon* review would apply to a mixed cash and stock transaction, Delaware courts are working their way through these fact patterns. *See Id.* at 70–71 (holding that 33% cash did not trigger *Revlon* duties); *In re* Smurfit-Stone, No. 6164-VCP, 2011 Del Ch. LEXIS 79, at *60 (May 20, 2011) (holding that a merger in which target shareholders would receive half cash, half stock, and ownership of 45% of the combined company, is in a *Revlon* mode); *In re* Lukens Inc. S'holders Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999), *aff'd sub nom.* Walker v. Lukens, Inc., 757 A.2d 1278 (Del. 2000) (suggesting that a merger that provided 62% of the consideration to target shareholders in

chancery has suggested replacing the *Blasius* standard of review with enhanced business judgment.[138] These extensions of enhanced business judgment review show that Delaware courts have perceived a need for an enhanced standard of review outside of *Unocal* fact pattern. Courts have, however, not provided straightforward explanations for their rationale for these extensions, nor have courts discussed whether these extensions present conflict-lite issues.

1. *Revlon* Transactions

Although the Delaware Supreme Court created enhanced business judgment in *Unocal* to monitor the directors' inherent conflict of interest when they are faced with a hostile tender offer, the court seamlessly decided to apply enhanced business judgment when directors are instead faced with a *Revlon* decision. *Mills Acquisition Co. v. MacMillan, Inc.*[139] was the first case in which the Delaware Supreme Court held that it will subject the board's conduct to enhanced scrutiny when the corporation is in a *Revlon* mode.[140] The Delaware Supreme Court's discussion of enhanced business judgment in *Mills* focused only on those *Revlon* situations where the target faces more than one bidder and qualified the application of enhanced business judgment on a plaintiff's prior demonstration that the target directors did not treat all bidders equally:

> [W]hen management of a target company determines that the company is for sale, the board's *responsibilities* under the enhanced *Unocal* standards are significantly altered. Although the board's *responsibilities* under *Unocal* are far different, the enhanced *duties* of the directors in responding to a potential shift in control, recognized in *Unocal,* remain unchanged. This principle pervades *Revlon*, and when directors conclude that an auction is appropriate, the standard by which their ensuing actions will be judged continues to be the enhanced duty imposed

cash would be in a *Revlon* mode). *Cf. In re* Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1047–48 (Del. Ch. 2012) (holding that no change of control occurred so as to trip *Revlon* duties where 65% of the purchase price was paid with the purchaser's publicly-traded stock, making it impossible for the purchaser to be a controlling shareholder); *In re* NYMEX S'holder Litig., Nos. 3621-VCN, 3835-VCN, 2009 WL 3206051, at *5–7 (Del. Ch. Sept. 30, 2009) (dismissing shareholder challenge to merger and finding transaction adequate that offered shareholders 36% cash at the time of the merger, and 44% cash at the closing of the merger, but declining to rule squarely on whether the corporation was in a *Revlon* mode).

138. *Mercier*, 929 A.2d at 810, 818.
139. 559 A.2d 1261 (Del. 1989).
140. *Id.* at 1287.

> by this Court in *Unocal*.
>
> . . . .
>
> When *Revlon* duties devolve upon directors, this Court will continue to exact an enhanced judicial scrutiny at the threshold. . . .
>
> At the outset, the plaintiff must show, and the trial court must find, that the directors of the target company treated one or more of the respective bidders on unequal terms. It is only then that the two-part threshold requirement of *Unocal* is truly invoked, for in *Revlon*, we held that . . . 'the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions.'[141]

Some nine years after it decided *Revlon*, the Delaware Supreme Court, in *Paramount Communications Inc. v. QVC Network, Inc.*, offered both a summary of enhanced review in the *Revlon* context that is not limited to auction scenarios and one that is. In its general description of how the components of enhanced business judgment operate in a *Revlon* context, the court stated:

> The key features of an enhanced judicial scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.[142]

The Delaware Supreme Court then explained why *Revlon* contexts require enhanced business judgment, at least in the factual scenario before the court:

> Board action in the circumstances presented here is subject to enhanced scrutiny. Such scrutiny is mandated by: (a) the threatened diminution of the current stockholders' voting power; (b) the fact that an asset belonging to public stockholders (a control premium) is being sold and may never be available again; and (c) the traditional concern of Delaware courts for actions

141. *Id.* at 1287–88 (quoting Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986)) (emphasis in original).

142. Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 45 (Del. 1994).

which impair or impede stockholder voting rights.[143]

Contrary to the court's statement, however, these facts only explain why the corporation is in a *Revlon* mode; they do not provide the basis for enhanced scrutiny.

The Delaware courts of chancery have offered some thoughtful explanations of why *Revlon* contexts require enhanced business judgment. One of the most helpful explanations was provided in *In re Dollar Thrifty Shareholder Litigation*,[144] where the court noted that when a change in corporate control occurs, "there is the danger that top corporate managers will resist a sale that might cost them their managerial posts, or prefer a sale to one industry rival rather than another for reasons having more to do with personal ego than with what is best for stockholders."[145] The court further explained its reason for applying enhanced business judgment in the *Revlon* context:

> One of the benefits of this approach is that it mandates that the court look closely at the motivations of the board. In adopting a reasonableness, rather than rationality, standard, *Revlon* and *Unocal* implicitly acknowledge that there is a predicate question that must be answered that is not typically at issue in a case governed by the business judgment rule. . . . In a situation where heightened scrutiny applies, the predicate question of what the board's true motivation was comes into play. The court must take a nuanced and realistic look at the possibility that personal interests short of pure self-dealing have influenced the board to block a bid or steer a deal to one bidder rather than another. Through this examination, the court seeks to assure itself that the board acted reasonably, in the sense of taking a logical and reasoned approach for the purpose of advancing a proper objective, and to thereby smoke out mere pretextual justifications for improperly motivated decisions. In this sense, the reasonableness standard requires the court to consider for itself whether the board is truly well motivated (i.e., is it acting for the proper ends?) before ultimately determining whether its means

143. *Id.* at 45. Even (c), judicial concern about actions that impede voting rights, does not automatically trigger enhanced business judgment. *See, e.g.*, City of Westland Police & Fire Ret. Sys. v. Axcelis Technologies, Inc., No. 4473-VCN, 2009 WL 3086537, at *7 (Del. Ch. Sept. 28, 2009) *aff'd*, 1 A.3d 281 (Del. 2010) (reviewing claims that board impeded shareholder voting rights under the business judgment rule); *see also infra* notes 212-215 and accompanying text.

144. 14 A.3d 573 (Del. Ch. 2010).

145. *Id.* at 597.

were themselves a reasonable way of advancing those ends.[146]

In explaining their reasons for applying enhanced business judgment in *Revlon* contexts, other courts have cited the language from *Unocal* and reasoned that there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders"[147] both when boards employ defensive measures and when a change of control is imminent.[148] In *Smurfit-Stone*, the court explained that "[h]eightened scrutiny is appropriate because of an 'omnipresent specter' that a board, which may have secured a continuing interest of some kind in the surviving entity, may favor its interests over those of the corporation's stockholders."[149] In both *Binks* and *Toys-R-Us*, the respective courts specifically identified that their mandate was to determine whether the board made its *Revlon* decisions with improper motives.[150] Similarly, in *Pennaco*, the court examined the board's motives and concluded that it was not likely that the directors were "motivated by the desire for employment-related benefits rather than their desire to receive the best price."[151]

It is not difficult to see that when corporations are in a *Revlon* mode, directors face the same type of motivational conflict that troubled the court in *Unocal*. Both scenarios present the distinct possibility that directors may lose their jobs. As such, *Revlon* cases present a conflict-lite issue: are the directors motivated to seek the best financial deal for shareholders (as *Revlon* requires) or are the directors motivated to select a suitor that treats target management and directors well?[152] As such, the Delaware Supreme Court's decision to apply enhanced business judgment to *Revlon* contexts was sound. Curiously, Delaware courts have ignored the fact that as

146. *Id.* at 597–98.

147. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

148. *See, e.g.*, Gilbert v. El Paso Co., 575 A.2d 1131, 1144 (Del. 1990); Barkan v. Amsted Indus., 567 A.2d 1279, 1286 (Del. 1989); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986); *In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076, at *13 (Del. Ch. May 20, 2011); *Dollar Thrifty*, 14 A.3d at 598 n. 180; *In re* Lukens Inc. Shareholders Litig., 757 A.2d 720, 731 (Del. Ch. 1999) *aff'd sub nom.* Walker v. Lukens, Inc., 757 A.2d 1278 (Del. 2000).

149. *Smurfit-Stone*, 2011 WL 2028076, at *13.

150. Binks v. DSL.net, Inc., No. 2823-VCN, 2010 WL 1713629, at *7–8 (Del. Ch. Apr. 29, 2010); *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1003 (Del. Ch. 2005).

151. *In re* Pennaco Energy, Inc., 787 A.2d 691, 707–08 (Del. Ch. 2001).

152. Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 839 (2007) (positing that a board's motives when the corporation is in a *Revlon* mode might be to select the bidder that offers retention or more generous severance to the directors and management).

*Revlon* contexts do not present a threat to corporate policy,[153] *Unocal*'s first prong is entirely inapplicable. The court's nonchalant adoption of enhanced business judgment in *Revlon* contexts despite the fact that there is no threat to the corporation in this context reinforces the point that the essence of enhanced business judgment is whether the board acted reasonably.[154]

In some respects, the Delaware courts allay their concern about the board's true motives in *Revlon* contexts just as these courts resolved this elusive issue in *Unocal*—by examining whether directors caused harm to their shareholders. If a board whose corporation is in a *Revlon* mode reasonably seeks to achieve profit maximization for its shareholders, the directors have not harmed their shareholders regardless of the board's "true" motivation, and regardless of whether the directors have secured employment with the acquirer. In other respects, the courts' attempt to discern a board's motive is easier when the target is in a *Revlon* mode, as opposed to a *Unocal* mode, and is easier still when the corporation is in a *Revlon* mode *and* faces offers from more than one bidder. The court's task is facilitated by *Revlon*'s mandate that requires the board to seek to maximize profits for its shareholders; that mandate provides a clear target against which a court can measure a board's efforts. Boards that are passive, or boards that favor a lower bid while in *Revlon* mode, simply make the case against themselves. In contrast, since *Unocal* requires courts to make a judgment call regarding the reasonableness of a board's response to a perceived corporate threat, the court's evaluation is measured against an ambiguous standard that may be further complicated by the consideration of the impact of the offer on divergent constituencies.[155]

As evidence that the *Revlon* mandate facilitates the court's task, consider the nature of the cases that have failed *Revlon*. Facts in six of the cases that failed *Revlon*, including the *Revlon* case itself, exposed the directors' motivational conflict: five cases involved management trying to further the deal that provided for their own continued participation, rather than the deal that was best for their shareholders,[156] and in *Revlon* the directors, concerned about their potential liability to Revlon's noteholders,[157] favored the lower bidder who promised to shore up these devalued notes. The facts of these cases facilitated the court's ability to

153. *See, e.g.*, *Revlon*, 506 A.2d at 182 (recognizing that corporations in a *Revlon* mode do not face threats to "corporate policy and effectiveness" as they no longer seek to remain independent).

154. *See supra* text at notes 134-135.

155. *See supra* notes 87-88.

156. *See* Siegel, *supra* note 13, at 629-32 nn.130-34 (identifying nature of cases that *failed* Revlon).

157. *Revlon*, 506 A.2d at 179.

identify the directors' motivational conflict, thereby making it fairly straight-forward to hold that the directors violated their fiduciary duties by acting in their own self-interest. In two of the remaining three cases that failed *Revlon*, the directors revealed their motivational conflict by doing little or nothing to achieve their *Revlon* mandate.[158] It is no surprise that no other fact pattern failed *Revlon*. In virtually all other *Revlon* cases where there were either no bidders or only one bidder and the directors were not totally passive, Delaware courts found it challenging to identify whether the board acted based on its motivational conflict.[159] Without objective evidence exposing the board's conflict, courts were, as in *Unocal,* unable to conclude that directors acted in breach of their fiduciary duties.

Although extending enhanced business judgment to another area of the law required minor adjustments,[160] this extension to *Revlon* fact-patterns proves both aspects of our theory about this standard of review. First, enhanced business judgment is designed to monitor motivational conflicts where concern exists that the directors are protecting their jobs or some other interest short of financial self-dealing.[161] Second, although directors in a *Revlon* mode may show their own cards, the court's inquiry about the directors' motive remains whether the board has acted reasonably. In evaluating whether the board's response was reasonable, the court's main concern is whether target directors have harmed their shareholders.

Despite these similarities, *Revlon* fact-patterns pose one significant difference that the Delaware courts have ignored: *Revlon* fact patterns will often afford shareholders the opportunity to vote on the proposed transaction.[162] In contrast, tender offer defensive tactics involve unilateral

158. *See* Koehler v. NetSpend Holdings Inc., No. 8373-VCG, 2013 WL 2181518, at *20 (Del. Ch. May 21, 2013) (finding unreasonable the board's lack of a market check, reliance on a poor substitute for a market check, and use of deal protection devices); *In re* DeSoto, Inc. S'holder Litig., Nos. 11221, 11222 Consolidated, 1990 Del. Ch. LEXIS 15 (Feb. 5, 1990) (criticizing the board for failure to canvass the market of bidders).

159. *See* Siegel, *supra* note 13, at 629-32 nn.130–134 (surveying *Revlon* cases).

160. For example, since there is no threat to the continued existence of the corporation, *Unocal*'s prongs had to be modified to fit the *Revlon* scenario. *See supra* note 153 and accompanying text.

161. *See, e.g.*, *Revlon*, 506 A.2d at 182 (expressing concern that the Revlon board's decisions may have been influenced more by fear of potential liability to noteholders than strict adherence to its duty of loyalty to shareholders); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (expressing concern that directors' may act out of a "desire to perpetuate themselves in office").

162. When a merger or sale of all assets puts the corporation in a *Revlon* mode, shareholders will vote on those transactions. *Cf.* Lawrence A. Hamermesh, *Premiums in Stock-For-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties*, 152 U. PA. L. REV. 881, 903 (2003) (arguing that courts should not apply enhanced scrutiny to a merger where shareholder approval is unimpaired regardless of whether the corporation

director action. Noting this fact, the Delaware Supreme Court in *Williams v. Geier* reasoned, "A *Unocal* analysis should be used only when a board unilaterally . . . adopts defensive measures in reaction to a perceived threat."[163] The question of whether a shareholder vote, or at least a disinterested shareholder vote, constitutes a sufficient monitor of the transaction so as to obviate the need for enhanced judicial review is an important one in Delaware law and is further addressed in Part III.[164]

2. Voting Issues

In both *Unocal* and *Revlon*, the court's decision to change the standard of review from business judgment to enhanced business judgment made it more difficult for directors to pass the new standard of review. In contrast, one chancery court decision, *Mercier v. Inter-Tel (Delaware), Inc.*,[165] sought to replace the *Blasius* standard of review with enhanced business judgment, thereby lowering the standard of review.[166] While concerns about motivational conflicts facing the board in both *Unocal* and *Revlon* prompted the court to apply enhanced business judgment so that it could examine the reasonableness of the board's actions, *Mercier*'s proposal to utilize enhanced business judgment instead of *Blasius* was generated by entirely different concerns. In *Mercier*, then Vice-Chancellor Strine eschewed the *Blasius* standard of review because "the trigger for the test's application—director action that has the primary purpose of disenfranchisement—is so pejorative that it is more a label for a result than a useful guide to determining what standard of review should be used by a judge to reach an appropriate result."[167] In other words, the chancery court's rejection of *Blasius* was based on its belief that *Blasius* is simply an unworkable standard of review, as once a court triggers *Blasius,* it would seem impossible for the directors to provide a compelling justification for disenfranchising their shareholders.[168] Thus, *Mercier*'s argument for applying enhanced business judgment was based on the court's view that a standard more viable than *Blasius* was needed to govern certain voting issues.[169] The need for a more workable standard is particularly acute in

is or is not in a *Revlon* mode).

163. 671 A.2d 1368, 1377 (Del. 1996).

164. *See* discussion *infra* Part III.D (explaining the impact of certain shareholder votes on judicial review).

165. 929 A.2d 786 (Del. Ch. 2007).

166. *Id.* at 806.

167. *Id*.

168. *See supra* notes 19–20 and accompanying text.

169. *Mercier*, 929 A.2d at 806. *See* Allen et. al, *supra* note 44, at 1316 ("Since the early 1990's, the court of chancery and the Delaware [S]upreme [C]ourt began to 'fold' the

voting cases because, under current Delaware law, cases that fail to trigger *Blasius* review are governed by the business judgment rule.[170]

The seeming futility of the *Blasius* standard of review, however, should not itself merit enhanced business judgment review for all voting issues. The chancery court in *Mercier*, however, viewed the facts as presenting the same two issues endemic to enhanced business judgment review: a board's motivational conflict and whether the board's response was reasonable. As a result, in seeking to apply enhanced business judgment in a voting context,[171] the court in *Mercier* proposed that plaintiffs would have to convince the court that the directors are motivated by an inherent conflict of interest involving their jobs. If so, the directors would bear the burden of showing both a valid corporate purpose for their conduct and that their response was within the range of reasonableness. Specifically, the court in *Mercier* proposed modifying enhanced business judgment for the voting context so that the board would bear the following burden in the facts at hand:

> [T]o identify a legitimate corporate objective served by its decision to reschedule the . . . special meeting on the Mitel Merger and to set a new record date . . . the directors should bear the burden of persuasion to show that their motivations were proper and not selfish. That showing, however, is not sufficient to ultimately prevail. To ultimately succeed, the directors must show that their actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way. If for some reason, the fit between means and end

*Blasius* standard into *Unocal*, effectively making the former a subset of the latter."); *Cf.* MM Companies, v. Liquid Audio, Inc., 813 A.2d 1118, 1129 (Del. 2003) ("This Court and the Court of Chancery have recognized the substantial degree of congruence between the rationale that led to the *Blasius* 'compelling justification' enhanced standard of judicial review and the logical extension of that rationale *within* the context of the *Unocal* enhanced standard of judicial review.") (emphasis in original); *see also* Keyser v. Curtis, No. 7109-VCN, 2012 WL 3115453, at *12 (Del. Ch. July 31, 2012) (deciding to apply entire fairness to the board's decision to issue preferred stock despite court's conclusion that such issuance was "the quintessential *Blasius* trigger").

170. *See* City of Westland Police & Fire Ret. Sys. v. Axcelis Technologies, Inc., 1 A.3d 281 (Del. 2010) (applying the business judgment rule after rejecting the suggestion that *Blasius* was applicable); *see also infra* notes 212-215 and accompanying text.

171. The court in *Mercier* considered a decision by a special committee of independent Inter-Tel directors to postpone a special meeting scheduled to submit a merger proposal for shareholder approval so as to provide shareholders additional information in the hope that they would approve the merger. *Mercier*, 929 A.2d at 797–804.

is not reasonable, the directors would also come up short.[172]

Since both *Unocal* and *Blasius* require review of the board's motivation, the court in *Mercier* assumed that this common core was a sufficient basis to substitute *Unocal* review for *Blasius* review. That common core, however, misses the mark. *Mercier*'s proposed substitution is inapt because it fails to recognize that the reasonableness review of *Unocal* is designed to give directors substantial leeway in making business decisions. In contrast, as the court in *Blasius* pointed out, deciding who is on the board is a shareholder governance issue, not a business decision.[173] As a result, whether the directors acted reasonably, or even entirely reasonably, is irrelevant, as the decision was not within the directors' domain.

Thus, although Delaware courts might find the *Blasius* standard unworkable, utilizing *Unocal* review would require Delaware courts to make one of two changes to the logic of *Blasius*. One option is to overrule that part of *Blasius* that reasoned that some aspects of governance are simply outside the directors' managerial domain.[174] If all matters, including who serves on the board, are in the directors' domain, then the reasonableness review of *Unocal* would be appropriate. The other option is to narrow within the voting issue those topics that merit *Blasius* review. For example, while the directors in *Blasius* acted to *preclude* the shareholders from electing certain candidates to the board, *Mercier* and several other voting cases reviewed under *Blasius* involved only either a temporary infringement on the shareholders' voting rights, or a vote on a transaction, not on the election of directors.[175]

172. *Id.* at 810–11. Once the court determined that the Mercier board passed *Unocal*, it "reason[ed] backwards" and found that passing *Unocal* demonstrated that the board had a compelling justification for its actions. *See id.* at 818–19 (finding that the primary purpose was to give stockholders more time to deliberate).

173. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659–60 (Del. Ch. 1988) ("A board's decision to act to [interfere with the shareholder franchise] does not involve the exercise of *the corporation's power* over its property . . . rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation. [This decision] may not be left to the [board's] business judgment.") (emphasis in original).

174. *See id.* at 660 (holding that board actions which involve the "exercise of *the corporation's power* over its property, or with respect to *its* rights or obligations" are properly within directors' domain, while board actions which invade "power with respect to governance of the corporation" properly reserved for shareholders are outside of the scope of directors' authority) (emphasis in original).

175. See *infra* notes 201-205 and accompanying text (comparing those voting cases about the election of directors that were decided under *Blasius* and those voting cases about other issues that were also decided under *Blasius*); *see also infra* notes 206-208 and accompanying text (discussing cases about delaying a shareholder vote that were reviewed

In sum, both *Revlon* fact patterns and voting fact patterns evince serious concerns regarding a board's motivation for its actions. Topics that generate a concern about the directors having a motivational conflict naturally create judicial interest in examining the reasonableness of the board's decision. In true *Blasius* cases, however, the reasonableness of the board's decision is irrelevant under current Delaware law. As such, subject to further consideration of whether a shareholder vote should change the standard of review,[176] extending enhanced business judgment to *Revlon* fact patterns makes sense. Voting cases, however, need further judicial pruning before they merit *Unocal* review, regardless of the unworkability of *Blasius*. After suggesting ways to improve the enhanced business judgment standard of review, the next section will examine several topics that fit neatly into the paradigm thus far delineated for this standard.

## III. APPLYING ENHANCED BUSINESS JUDGMENT TO OTHER CONTEXTS

Before examining other topics that might merit review under enhanced business judgment, two issues require consideration. First, can enhanced business judgment be made into a stronger standard of review, even if not a truly intermediate standard? Second, in considering scenarios to which enhanced business judgment could be applied because those topics meet the criteria that animated *Unocal*, should topics in which shareholders have a vote be removed from this heightened review because the shareholder vote itself provides some level of monitoring?

### *A. Reformulating Enhanced Business Judgment into a Stronger Standard of Review*

Reformulating enhanced business judgment into a stronger standard of review is not as difficult as it might appear. Since scholars and jurists agree that portions of two opinions from the Delaware Supreme Court, *Paramount Communications, Inc. v. Time, Inc.*,[177] and *Unitrin, Inc. v. American General, Corp.*,[178] have weakened enhanced business judgment, reformulating this standard of review would require the Delaware Supreme Court to reconsider aspects of these opinions. Specifically, in *Time*, the Delaware Supreme Court agreed with the Time directors that the all cash, all shares offer by Paramount was a threat to Time's corporate policy

under enhanced business judgment).

176. *See infra* Part III.D (discussing the role of the shareholder vote as a monitor).

177. 571 A.2d 1140 (Del. 1990).

178. 651 A.2d 1361 (Del. 1995).

because Paramount's offer was substantively coercive.[179] Professors Gilson and Kraakman had defined substantive coercion as "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value."[180] These professors cautioned that the doctrine is premised on shaky grounds:

> To note abstractly that management *might* know shareholder interests better than shareholders themselves do cannot be a basis for rubber-stamping management's pro forma claims in the face of market skepticism and the enormous opportunity losses that threaten target shareholders when hostile offers are defeated. Preclusive defensive tactics are gambles made on behalf of target shareholders by presumptively self-interested players.[181]

In *Time,* the Delaware Supreme Court nevertheless embraced the doctrine of substantive coercion.[182] On the eve of the vote on a Time-Warner merger, Paramount made a substantially higher all cash, all shares offer for Time stock.[183] Time responded by entering into an agreement to acquire Warner outright; the agreement included a provision legally binding Time to complete the transaction, thereby thwarting Paramount's offer.[184] The Delaware Supreme Court agreed with the Time board that Time stockholders might accept Paramount's offer "in ignorance or a mistaken belief of the strategic benefit which a business combination with

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179. *Paramount*, 571 A.2d at 1153.

180. Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard For Defensive Tactics: Is There Substance To Proportionality Review?*, 44 BUS. LAW. 247, 258, 267 (1989) (differentiating substantive coercion, "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value," from structural coercion, which the authors defined as "the risk that disparate treatment of non-tendering shareholders might distort shareholders' tender decisions," and also from opportunity loss, which the authors defined as the "dilemma that a hostile offer might deprive target shareholders of the opportunity to select a superior alternative offered by target management.").

181. *Id.* at 274.

182. *Time*, 571 A.2d at 1153 (defining substantive coercion as "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value" and find that such risk was present because "Time shareholders might elect to tender to Paramount's cash offer in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce.").

183. *Id.* at 1147 (finding that the "appeared accomplished fact" of the Time-Warner merger was "shattered by Paramount's surprising announcement" of a substantially higher all-cash offer).

184. *Id.* at 1148 (discussing the decision of Time's board to "recast its consolidation with Warner into an outright cash and securities acquisition of Warner by Time . . . .").

Warner might produce."[185] The Delaware Supreme Court also accepted the contention of Time's board that the timing of the Paramount offer, coming only weeks before the Time shareholders were to vote on the proposed merger with Warner, may have been designed to "confuse" the Time stockholders.[186] So viewed, the Delaware Supreme Court in *Time* permitted the board to satisfy *Unocal*'s first prong by reasoning that Paramount's offer was a threat to the proposed Time-Warner merger,[187] and Time's response was neither draconian nor unreasonable because the Time board did only what it needed to do to effectuate that merger.[188] In other words, since the Time board believed in the combination with Warner, it did not matter either to Time's board or to the Delaware Supreme Court what Time's shareholders wanted. Instead, the Delaware Supreme Court viewed *Unocal* as requiring the court to let the target board further the course of action in which it believed.[189]

The Delaware Supreme Court further embraced the doctrine of substantive coercion in *Unitrin, Inc. v. American General Corp.*,[190] where the target, Unitrin, proposed to implement both a stock repurchase and a poison pill in response to what the board viewed as an inadequate all cash offer from American General. In citing with approval its reasoning in *Time*, the Delaware Supreme Court in *Unitrin* stated that the Time board was concerned not only about the value of Paramount's offer, but also that "the Time stockholders might tender to Paramount in ignorance or based on a mistaken belief, *i.e.*, yield to substantive coercion."[191] Echoing its line of reasoning in *Time*, the court in *Unitrin* similarly stated that the Unitrin board "reasonably perceived risk of substantive coercion,"[192] fearing that its shareholders would accept American General's offer without understanding the Unitrin board's "assessment of the long-term value of Unitrin's stock."[193] The Delaware Supreme Court thus found the Unitrin board had identified a threat and that both of its defensive tactics were reasonable under *Unocal*.[194]

185. *Id.* at 1153.
186. *Id.*
187. *Id.* at 1153-54 (holding that the Time board's decision that Paramount's offer posed a threat to corporate policy and effectiveness satisfied *Unocal*'s first prong).
188. *Id.* at 1154-55 (finding Time's response satisfied Unocal's second prong as it was reasonable for the board to pursue its goal of effectuating the desired transaction with Warner).
189. *Id.* (claiming it would be a "distortion of the *Unocal* process" for the court to evaluate the merits of the various offers on the short and long-term value of Time).
190. 651 A.2d 1361 (Del. 1995).
191. *Id.* at 1384.
192. *Id.* at 1385.
193. *Id.*
194. *Id.*

Not content simply to disagree with its chancery court, which had held that *Unitrin*'s stock repurchase program violated *Unocal*'s second prong, the Delaware Supreme Court held that the chancery court "erred by substituting its judgment, that the Repurchase Program was unnecessary, for that of the Board."[195] Through use of the word "unnecessary," the Delaware Supreme Court suggested that the chancery court had used its business judgment to strike down the stock repurchase. Lost in the Supreme Court's analysis was that the chancery court's reason for striking down the repurchase: given that the Unitrin board had already adopted a poison pill, not only was the repurchase unnecessary to protect the stockholders from an inadequate bid but the repurchase also made it extremely difficult for the offeror to wage a viable proxy contest. Thus, in contrast to the Supreme Court's charge that the chancery court violated *Unocal* by substituting its judgment as to what was necessary for that of the board, the chancery court thought it was fulfilling *Unocal*'s ultimate teaching: protect the shareholders' right to vote their directors out of office.[196]

While the Delaware Supreme Court believed its chancery court had attempted to invade the realm of the boards' business judgment, it is arguable that the Delaware Supreme Court had instead simply been too deferential to the board's decisions. After all, enhanced business judgment was supposed to involve *the court* evaluating whether inherently-conflicted target directors had identified a cognizable threat and had responded reasonably. In *Time* and *Unitrin*, enhanced business judgment morphed into whether the hostile offer was a threat to what the board wanted, and whether the board responded reasonably in protecting what it wanted.

Some Delaware chancery courts have artfully criticized these aspects of *Time* and *Unitrin*. One line of attack is that these cases demean target shareholders. As then Vice-Chancellor Strine reasoned in *Chesapeake v. Shore*: "Our law should . . . hesitate to ascribe rube-like qualities to stockholders. If stockholders are presumed competent to buy stock in the first place, why are they not presumed competent to decide when to sell in a tender offer after an adequate time for deliberation has been afforded them?"[197]

Other chancery judges have openly stated their disagreement with the Delaware Supreme Court's view of substantive coercion. For example, in

195. *Id.* at 1389.

196. *See supra* text accompanying notes 70, 108 (noting that if shareholders were unhappy with the decision of their directors to employ defensive tactics, the shareholders possessed the power to remove their directors or vote for a new board).

197. Chesapeake v. Shore, 771 A.2d 293, 328 (Del. Ch. 2000).

*Air Products & Chemicals v. Airgas*,[198] the negotiations had produced Air Products' final offer, which Airgas' directors still found inadequate. Thus, at this point in the negotiations, Airgas' poison pill served only to prevent its shareholders from tendering to Air Products tender offer. Noting that he did not agree with the Delaware Supreme Court's view of substantive coercion, Chancellor Chandler reasoned that until the Supreme Court modifies its views on this topic, the chancery court had no option other than to allow the target board to keep its pill in place.[199] In essence, the target board could prevent a hostile offer from succeeding not just temporarily, to produce a higher offer, but permanently, solely because the target directors continued to believe the offer was inadequate. Leaving the offer to the judgment of the target shareholders, as Chancellor Chandler preferred, was not on the table.

Thus, revitalizing enhanced business judgment requires recognizing that *Unocal*'s premise, namely, that target directors have an inherent conflict of interest, and the doctrine of substantive coercion, are largely incompatible. Inherently conflicted directors should be able to employ defensive tactics to obtain a better deal, or to obtain time to inform their shareholders about why the board opposes the offer. But inherently conflicted directors should not be allowed to say "not now, not ever." The doctrine of substantive coercion must eventually fall to the judgment of target shareholders. When the Delaware Supreme Court is willing to so cabin the doctrine of substantive coercion, enhanced business judgment will become a stronger standard of review.

### *B. Extending Enhanced Business Judgment to Other Contexts*

#### 1. Voting

The discussion above exposed that although *Blasius* might be a flawed standard of review, that observation alone does not merit relegating all voting issues to enhanced business judgment because some voting issues are not matters of the board's business judgment.[200] Thus, when presented with director conduct that impacts shareholders' voting rights, Delaware courts should first differentiate between issues that are properly subject to

198. 16 A.3d 48 (Del. Ch. 2011).

199. *Id.* at 101 (reasoning that "unless and until the Supreme Court rules otherwise," the current state of Delaware law did not permit the court to require directors to dismantle its poison pill or submit the transaction to the shareholders for a vote).

200. *See supra* text at note 173 (discussing that since who is on the board is not a proper subject for the directors' business judgment, enhanced business judgment review is an inappropriate monitor for such decisions).

the directors' business judgment and those that are not. Currently, Delaware courts have applied *Blasius* review to five other voting cases.[201] Only *Blasius* and three of these other cases, however, merited *Blasius* review as these cases involved director action that, like *Blasius* itself, precluded shareholders from deciding who would sit on the board.[202] The other two cases, *Peerless* and *Mercier*,[203] did not warrant the *Blasius* review they received as these boards proposed only delaying a shareholder vote on issues unrelated to the election of directors.[204] Thus, these latter cases should not have triggered *Blasius* review because they did not involve the directors usurping shareholder authority over who should serve on the board.[205]

Once a voting case does not warrant *Blasius* review, the question becomes which other standard of review is appropriate. In order to merit enhanced business judgment review, the court would have to decide that the directors faced a motivational conflict of interest. Delaware courts have applied enhanced business judgment to two voting cases, *Ahmanson*[206] and *Kidsco*,[207] involving target directors who delayed a shareholder vote on

201. MM Companies, Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1120 (Del. 2003); Mercier v. Inter-Tel (Del.), Inc., 929 A.2d 786 (Del. Ch. 2007); Perlegos v. Atmel Corp., CIV.A. 2320-N, 2007 WL 475453 (Del. Ch. Feb. 8, 2007); Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000); State of Wis. Inv. Bd. v. Peerless Sys. Corp., 2000 WL 1805376, at *2, *11–14 (Del. Ch. Dec. 4, 2000).

202. The three cases that merited *Blasius* review were *Liquid Audio*, 813 A.2d at 1120 (finding that increasing the size of the board from five to seven enabled the board to fill the new vacancies with loyal directors thus preventing any real challengers without directors offering a compelling justification for their actions), *Perlegos*, 2007 WL 475453 at *3–9 (concluding that the board did not provide a compelling justification for cancelling a legitimately called shareholder election and thereby precluding the shareholders from voting), and *Chesapeake*, 772 A.2d at 297 (finding that the board intended to "interfere with or impede" the shareholder vote when the board adopted a bylaw that both eliminated the ability of shareholders to call a special meeting and raised the vote to amend the bylaws from a majority to a supermajority).

203. *Peerless*, 2000 WL 1805376; *Mercier*, 929 A.2d at 786.

204. *See Peerless*, 2000 WL 1805376, at *9–11 (noting that the defendant board delayed a proxy vote for thirty days because the board was concerned that shareholders would not pass a proposal); *See also Mercier*, 929 A.2d at 798 (stating that, "[t]he Special Committee delayed the vote precisely so that it could have more time to convince the stockholders to support the Merger.").

205. The court in *Peerless* clouded the issue of the applicability of *Blasius* review by suggesting that *Blasius* review is appropriate any time directors make any effort to alter the results of the vote. *Peerless*, 2000 WL 1805376 at *19 ("It is clear, however, that adjournments that are specifically aimed at interfering with the results of a valid shareholder vote will bestir deep judicial suspicion.").

206. H.F. Ahmanson & Co. v. Great W. Fin. Corp., No. CIV. A. 15650, 1997 WL 305824 (Del. Ch. June 3, 1997).

207. Kidsco Inc. v. Dinsmore, 674 A.2d 483 (Del. Ch. 1995) *aff'd and remanded*, 670 A.2d 1338 (Del. 1995).

a proposed merger into a white knight to buy more time to convince shareholders that the merger was a good idea.[208] Since both mergers were defensive responses to hostile bids, both boards faced a motivational conflict that made enhanced business judgment the appropriate standard of review. Similarly, the two cases that were wrongly decided under *Blasius*—*Mercier* and *Peerless*—would have been good candidates for enhanced business judgment review. In both of these cases, the board temporarily delayed a shareholder vote on matters unrelated to the *Blasius* issue of who would select the board. Furthermore, both cases involved motivational conflicts, thereby making enhanced business judgment review appropriate. The facts in *Mercier* replicated those in *Ahmanson* and *Kidsco* in that the directors in *Mercier* postponed a special shareholder vote on a proposed merger so that the board could have additional time to convince its shareholders to vote for the proposed merger.[209] Similarly, in *Peerless*, the board postponed a proxy vote for thirty days to have more time to convince its shareholders to vote for a proposal that would add 1,000,000 shares to the Peerless stock option plan, an addition which would potentially benefit the Peerless directors.[210] The court expressed concern over the directors' efforts to use the postponement period to contact only those shareholders whom the board believed would vote for the pending proposal.[211] As such, the Peerless directors had questionable motives for their actions, which warranted review under enhanced business judgment.

Finally, voting cases that have been decided under the business judgment rule that present motivational conflicts are also candidates for enhanced business judgment review. Perhaps the best example of a case that warranted review under enhanced business judgment instead of business judgment review is *City of Westland Police & Fire Ret. Sys. v. Axcelis Technologies, Inc.*[212] In that case, the board had enacted a plurality-plus voting policy that gave the board the discretion to reject resignations proffered by incumbent candidates who did not receive the support of a majority of the shares.[213] When three directors failed to garner the requisite

208. In *Ahmanson*, the court applied *Unocal* when the board delayed the shareholder vote by fifty days. *See Ahmanson*, 1997 WL 305824 at *16. Similarly, in *Kidsco*, the court applied *Unocal* review to the board's response to a hostile takeover by delaying a shareholder vote on a proposed merger by twenty five days. *Kidsco*, 674 A.2d at 468–89.

209. *See Mercier*, 929 A.2d at 798 ("The Special Committee delayed the vote precisely so that it could have more time to convince the stockholders to support the Merger.").

210. *Peerless*, 2000 WL 1805376 at *9–11.

211. *Id.*

212. 1 A.3d 281 (Del. 2010).

213. The plurality-plus election policy forced directors who received only a plurality of votes to submit their resignations to the board and further gave the sitting directors the power to accept or reject the proffered resignations. *Id.* at 283–84.

vote, they submitted their resignations to the board, which then rejected those resignations.[214] Although teeing up the issue of the board's motivation,[215] the court set it aside when it chose to apply the business judgment rule. Instead, the motivational conflict that the directors potentially faced in choosing to keep their fellow directors on the board fit squarely within the parameters of enhanced business judgment review. The concerns about the Westland board's motives are reminiscent of the entrenchment issues that the Unocal board faced that originally prompted the Delaware Supreme Court to create the enhanced business judgment standard of review.

2. Exclusive Forum Bylaws

While Delaware courts have held that board-adopted forum-selection bylaws are valid[216] and reviewable under the business judgment rule,[217] a few judges and scholars have suggested that the board's implementation of such bylaws may warrant a different standard of review.[218] Such bifurcated review between adoption and implementation of these clauses has roots in Delaware corporate law; previously, the Delaware Supreme Court subjected a board's adoption of a poison pill in advance of any takeover threat to business judgment rule review, while simultaneously holding that implementation of the pill could be reviewed under the enhanced business

214. *Id.* at 291.

215. "The question arises whether the directors, as fiduciaries, made a disinterested, informed business judgment . . . or whether the Board had some different, ulterior motivation." *Id.* at 291.

216. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 954 (Del. Ch. 2013); Edgen Grp., Inc. v. Genoud, C.A., No. 9055-VCL, slip op. at 30 (Del. Ch. Nov. 5, 2013) (describing forum-selection clauses found in bylaws as presumptively valid) (citing *Boilermakers*); *cf.* In re Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (implying forum-selection provisions in a charter are valid since charter provisions require both a board recommendation and shareholder approval). *But see* Galaviz v. Berg, 763 F. Supp. 2d 1170, 1175 (N.D. Cal. 2011) (holding a board-adopted forum-selection bylaw invalid under federal law).

217. *Boilermakers*, 73 A.3d at 949 (citing Stroud v. Grace, 606 A.2d 75 (Del. 1992) and Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985) as the basis for its holding that adoption of such bylaws warrants review under the business judgment rule).

218. Joseph A. Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches (The 2010 Pileggi Lecture)* (Rock Center for Corporate Governance at Stanford University, Working Paper No. 91, 2010), *available at* http://ssrn.com/abstract=1690561 (noting that as management's incentives in litigation may be different from maximizing shareholders' best interests, *Unocal* could monitor this concern); *Boilermakers*, 73 A.3d at 953 (analogizing the factual scenario before it to the factual scenario confronted in Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985), where the court left open the possibility that it would apply enhanced business judgment review in the future if the board implemented the poison pill it had adopted).

judgment rule.[219] Similarly, in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, then Chancellor Strine upheld the adoption of a forum-selection bylaw, but saved for another day ruling on the validity of a board's decision to implement an exclusive-forum bylaw, reasoning that Delaware courts "decline[] to wade deeper into imagined situations involving multiple 'ifs' because rules on these situationally specific kind of issues should occur *if and when* the need for rulings is actually necessary."[220] As a result, even though Delaware courts deem the board's adoption of forum bylaws to be a valid exercise of power, courts may apply a more searching scrutiny when a board actually implements such clauses.

In *Boilermakers*, then Chancellor Strine stated that the court would review implementation of a forum-selection bylaw under the test articulated by the United States Supreme Court in *Bremen v. Zapata Off-Shore Co.*,[221] a case involving an international towing contract: "[T]his court will enforce the forum selection bylaws in the same way it enforces any other forum selection clause, in accordance with the principles set down by the United States Supreme Court in *Bremen*."[222] The *Bremen* test requires a court to enforce such a clause absent a showing that "enforcement would be unreasonable and unjust,"[223] or that the clause was invalid because it was affected by "fraud, undue influence, or overweening bargaining power."[224] The forum-selection clause in *Bremen*, however, involved two parties to a contract.[225] In contrast, forum-selection bylaws involve only one party—who unilaterally both adopts and implements the clause—and who is a *fiduciary* to the other party. As a result, the *Bremen* analogy is not quite apt for review of forum-selection bylaws.[226]

219. *Moran*, 500 A.2d at 1357 (ruling that "the ultimate response to an actual takeover bid must be judged by the Directors' actions at that time").

220. *Boilermakers*, 73 A.3d at 962. Chancellor Strine cited to *Moran* in his decision, suggesting that, similar to the poison pill in *Moran*, implementation of an exclusive forum bylaw may well be subject to a higher standard of review. *Id.* at 949 n.59 (emphasis in original).

221. 407 U.S. 1 (1972).

222. *Boilermakers*, 73 A.3d at 940. The court in *Boilermakers* implied that it might apply more searching scrutiny than is done under the business judgment rule, but specifically mentioned review under only Bremen & Schnell v. Chris-Craft Industries, Inc., 285 A.2d 437 (Del. 1971). *Id.* at 940, 949. *But see* Mary Siegel, *Going Private: Three Doctrines Gone Astray*, 4 N.Y.U.J. L. & BUS. 399, 420 (2008) (demonstrating that *Schnell* is best cabined to voting issues).

223. *Bremen*, 407 U.S. at 15.

224. *Id.* at 12.

225. *Id.* at 2-3 (describing the exchange between two parties and noting that while one party drafted the original contract, the other reviewed it and made several changes before accepting the contract).

226. When instituting suit, contract parties must abide by the forum-selection clause. In contrast, a forum-selection bylaw differs in that directors owe fiduciary duties to the

While directors have many valid reasons to implement forum-selection clauses,[227] the advantages that directors reap from implementing such clauses can certainly generate a motivational conflict for the board. For example, the forum the directors select through either a mandatory or elective forum clause[228] can deter meritorious suits by making it geographically difficult for plaintiff to pursue its action,[229] decreasing incentives for plaintiff's counsel to pursue the lawsuit,[230] or imposing more

corporation and to the shareholders. The addition of a fiduciary component to the relationship between parties means that a higher standard of conduct is expected. *Cf.* Monica E. White, *"Package Deal": The Curious Relationship Between Fiduciary Duties and the Implied Covenant of Good Faith and Fair Dealing in Delaware Limited Liability Companies*, 21 U. MIAMI BUS. L. REV. 111, 130 (2013) (comparing and contrasting the implied covenant of good faith and fair dealing and the fiduciary duty of good faith in Delaware law).

227. The most often cited reason for directors adopting forum-selection clauses is that multi-forum litigation regarding a single corporate action imposes a high cost on the corporation. Such litigation is expensive, regardless of the merits of the shareholders' claims. Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum-selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 338, 346 (2013). Multi-forum litigation concerning a single action also introduces the potential for "opportunistic settlements." *Id.* at 329. Beyond the financial costs, multi-forum litigation potentially exposes corporations to "conflicting outcomes in different jurisdictions in the same case." Thomas T. McClendon, *The Power of A Suggestion: The Use of Forum-Selection Clauses by Delaware Corporations*, 69 WASH. & LEE L. REV. 2067, 2116 (2012). Note that each of these examples seeks to maximize the corporation's profits. The directors' motivation differs from the motivation of the suing shareholders' attorneys who act not to maximize the corporation's profits, but to maximize the counsel fees they can collect. *See* Joseph A. Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches (The 2010 Pileggi Lecture)* (Rock Center for Corporate Governance at Stanford University, Working Paper No. 91, 2010), *available at* http://ssrn.com/abstract=1690561 (noting that Plaintiff's counsel might prefer a jurisdiction that awards higher attorney fees even if it is less lucrative for investors).

228. Forum-selection provisions can be either mandatory or elective, also referred to as permissive. Mandatory forum-selection provisions limit shareholder suits to the jurisdiction specified in the provision. Elective, or permissive, forum-selection provisions give directors discretion either to consent to the jurisdiction chosen by the suing shareholders or require litigation to proceed in the jurisdiction specified in the provision.

229. *See* GLASS LEWIS & CO., *Proxy Talk: Amalgamated Bank Discusses Exclusive Forum Shareholder Proposal at Chevron* (May 17, 2012), http://www.glasslewis.com/about-glass-lewis/press-releases/ (raising several issues about the negative impact of a forum-selection clause, including that it allows the corporation to engage in gamesmanship to the detriment of plaintiffs and may force litigation into a jurisdiction that may not be the most efficient for the particular litigation).

230. *See* John Armour, Bernard Black & Brian Cheffins, *Delaware's Balancing Act*, 87 IND. L.J. 1345, 1367–72 (2012) (finding that negative Delaware judicial attitudes towards plaintiffs' counsel and their fees might have an impact on the recent trend of plaintiffs' attorneys fleeing filing in Delaware); Sara Lewis, *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*, 14 STAN. J.L. BUS. & FIN. 199, 200–02 (2008) (arguing that shareholders' attorneys are increasingly suing

stringent pleading or substantive requirements on plaintiff.[231] Alternatively, directors can use the power of this clause to extract a "sweetheart settlement."[232] If a court determines that directors faced a motivational conflict when they implemented a forum bylaw, the court could hold that enhanced business judgment is the appropriate standard of review.

If a court were to apply enhanced business judgment review to implementation of these clauses, it would have to consider whether the board's decision was reasonable and the extent of the harm that decision caused shareholders.[233] Presumably, it would always be reasonable for directors of Delaware corporations to want to keep lawsuits in front of Delaware judges. To the extent, however, that such a clause empowers a

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corporations in jurisdictions other than Delaware to avoid what is viewed as the pro-corporation efficiency and predictability of Delaware courts).

231. *See*, *e.g.*, Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000) (explaining the heightened pleading standards required in derivative suits in Delaware); Pirelli Armstrong Tire Corp. Retiree Med. Benefits Trust *ex rel.* Fed. Nat'l Mortg. Ass'n v. Raines, 534 F.3d 779, 783 (D.C. Cir. 2008) (characterizing Delaware's demand futility requirement as setting the bar high and requiring stringent standards).

232. *See* Joseph A. Grundfest, *Choice of Forum Provisions in Intra-Corporate Litigation: Mandatory and Elective Approaches (The 2010 Pileggi Lecture)* (Rock Center for Corporate Governance at Stanford University, Working Paper No. 91, 2010), *available at* http://ssrn.com/abstract=1690561 ("The rationale for such a standard relates to the potential danger of a sweetheart settlement that parallels the danger of entrenchment in the *Unocal* situation."); *cf.* Note, *When Should Courts Allow the Settlement of Duty-of-Loyalty Derivative Suits?*, 109 HARV. L. REV. 1084, 1087 (1996) (highlighting the danger of sweetheart settlements in derivative suits). Concern about the board's motivations may be the underlying reason that some proxy-advisor firms recommend voting against directors who support these provisions. *See* Claudia H. Allen, *Study of Delaware Forum-selection in Charters and Bylaws* (Katten Muchin Rosenman LLP) (January 25, 2012), at 6, *available at* http://www.ngelaw.com/files/Uploads/Images/StudyofDelawareForum012512.pdf.

233. This review mirrors the reasonableness analysis envisioned by the Court in *Bremen* in that it focuses on the effect of the clause's implementation. *See* Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15–17 (1972) (implying enforcement of a forum-selection clause would be unreasonable if it were contrary to public policy or forced litigation into a remote foreign forum). Just as *Unocal's* second prong allows the court to review harm to the corporation and its shareholders, *Bremen's* reasonableness standard permits the court to analyze harm to the contracting parties. However, reasonableness analysis under the enhanced business judgment rule is meant to be more delving than it is under *Bremen*. Review under *Bremen* considers only the facial reasonableness of the forum-selection clause. *See id.* at 15–18 (finding the forum-selection clause reasonable given that it did not conflict with the forum's public policy, the chosen forum wasn't seriously inconvenient, and the contract containing the forum-selection clause was freely negotiated). In contrast, reasonableness review under enhanced business judgment is designed to be somewhat probing. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (describing the reasonableness test under *Unocal* as examining whether the directors' beliefs were reasonable, whether the directors reasonably investigated those beliefs, and whether the directors' actions in response were reasonable).

board with a useful club against plaintiffs' lawyers who eschew Delaware courts (known to be less generous with plaintiffs' counsel fees than other jurisdictions),[234] Delaware courts could use enhanced business judgment review to ensure that these parties have not reached a sweetheart settlement for themselves at the expense of their shareholders.[235]

### C. *The Costs and Benefits of Extending Enhanced Business Judgment Review*

Increasing review to enhanced business judgment for topics that are currently reviewed under the business judgment rule would require boards to justify the reasonableness of their actions in implementing exclusive forum bylaws or in unilaterally-adopted board voting policies. This increase in the standard of review means a transfer of discretion from directors to courts. Commentators will differ on whether this transfer of power yields a cost or a benefit. Perhaps a clearer cost of extending enhanced review is increased uncertainty, as parties will not know *ex ante* whether a judge will find the board's actions to be reasonable.

In contrast, reviewing topics under enhanced business judgment that are currently viewed under *Blasius* creates a distinct benefit for directors who would move from having to provide a compelling reason for their actions to the far lesser standard of demonstrating the reasonableness of their actions. Since courts have framed the *Blasius* trigger as whether directors' primary purpose is to disenfranchise their shareholders,[236] these cases are perfectly tailored to *Unocal's* focus on the board's motivation. It is therefore likely that shareholders will not suffer a loss from *Unocal's*

234. *See* Armour, Black, & Cheffins, *supra* note 230, at 1367–72.

235. For example, directors could trade off a larger settlement in exchange for an agreement that the directors had not breached their fiduciary duties. Moreover, Delaware courts could use enhanced business judgment review to protect shareholders from directors pursuing more expensive litigation in faraway jurisdictions in hopes of obtaining a better result for themselves. Some argue that plaintiffs' lawyers increasingly pursue shareholder litigation outside of Delaware because some foreign jurisdictions apply Delaware law differently from Delaware courts, or apply their own law, which does not comport with Delaware law. *See, e.g.*, Sara Lewis, *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*, 14 STAN. J.L. BUS. & FIN. 199, 200–02 (2008) (noting that non-Delaware courts may not be consistent in applying Delaware law because non-Delaware judges are either unfamiliar with Delaware law or are hostile to it). By implementing a forum-selection clause, directors could take a similar approach, effectively paying an increased price at the corporation's expense to "roll the dice" in a less predictable jurisdiction.

236. *See supra* text at note 15 (stating that the *Blasius* test applies when directors' primary purpose is to disenfranchise shareholders and must demonstrate a compelling justification to justify their actions).

less demanding standard of review if courts apply *Unocal*'s reasonableness test to directors' efforts to merely postpone shareholder votes, rather than to outright disenfranchise their shareholders.[237]

### D. *What Effect Should A Shareholder Vote Have On The Standard of Review?*

In *Gantler v. Stephens*, a case not involving enhanced review, the Delaware Supreme Court clarified the scope and effect of the doctrine of shareholder ratification:

> We hold that the scope of the shareholder ratification doctrine must be limited to its so-called 'classic' form; that is, to circumstances where a fully informed shareholder vote approves director action that does *not* legally require shareholder approval in order to become legally effective. Moreover, the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve. With one exception, the 'cleansing' effect of such a ratifying shareholder vote is to subject the challenged director action to business judgment review, as opposed to 'extinguishing' the claim altogether (*i.e.*, obviating all judicial review of the challenged action.)[238]

Thus, under the holding in *Gantler*, directors submitting their actions or transactions to a shareholder vote where no such vote is required could change the standard of review from enhanced business judgment to the business judgment rule. This extension of *Gantler* is consistent with *Williams v. Geier*, where the Delaware Supreme Court stated that "[a] *Unocal* analysis should be used only when a board *unilaterally* . . . adopts defensive measures."[239] Since some of the existing topics and all proposed topics for enhanced review do not require a shareholder vote, boards theoretically have many opportunities to change the standard to business

237. *See supra* notes 202-204 and accompanying text (dissecting cases that were decided under Blasius and categorizing those that rightfully belonged under *Blasius* and those that did not).

238. 965 A.2d 695, 713 (Del. 2009) (emphasis in original) (citations omitted); *see also* Hamermesh, *supra* note 162, at 893 (arguing that a less intrusive level of judicial scrutiny would be more appropriate where there is an uncoerced and fully informed shareholder vote); *cf. In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013) (switching the standard of review from entire fairness to the business judgment rule in a going-private merger because both a committee of independent directors and a majority-of-the-minority shares approved the transaction).

239. 671 A.2d 1368, 1377 (Del. 1996) (emphasis added).

judgment. Note, however, that the Delaware Supreme Court in *In re Santa Fe Pacific Corporation Shareholder Litigation* distinguished the effect of voting on the proposed merger from voting on the defensive measures: "[s]ince the stockholders of Santa Fe merely voted in favor of the merger and not the defensive measures, we decline to find ratification in this instance."[240]

One might question, however, whether the *Gantler* logic holds when applied to some existing or proposed issues subject to enhanced review. No doubt, shareholders are able to make effective voting choices on issues directly relating to their financial self-interest.[241] Application of the *Gantler* logic to those *Revlon* transactions (which do not statutorily require shareholder approval) and to non-*Blasius* voting issues on transactions makes sense, as shareholders are able to decide what is in their financial self-interest. One step removed yet close enough to a transaction is the case of a target board voluntarily submitting proposed defensive tactics to their shareholders for a vote in the midst of a hostile tender offer. This scenario is analogous to a transaction because shareholders have a similar financial stake in selling their shares in a tender offer. Therefore, if the target directors ceded the right to decide on defensive tactics to their shareholders in the face of a hostile offer, the directors would shed their taint of improper motivation.[242] Directors submitting defensive tactics to a shareholder vote is an unlikely scenario, however, given that shareholders are likely to prefer the premium typically offered in a tender offer.

The *Gantler* logic becomes more questionable when applied to other contexts that are covered, or proposed to be covered, by enhanced business judgment that are not transaction specific. Specifically, if defensive tactics

240. 669 A.2d 59, 68 (Del. 1995); *see also* Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009) (reasoning that "the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve.").

241. Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010) ("[S]tockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."); Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987) ("Stockholders in Delaware corporations have a right to control and vote their shares in their own interest . . . It is not objectionable that their motive may be for personal profit."); Hamermesh, *supra* note 162, at 893 ("A more intrusive level of judicial involvement undervalues the significance of the shareholder franchise and the ability of shareholders to make effective voting choices as to issues affecting their financial interests."); *cf.* Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 623 (2007) (asserting that shareholders are likely to be better informed regarding "very important matters").

242. *Cf.* Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 313 (Del. Ch. 2010) (reasoning that one factor that helped the target board pass *Unocal* review was that the board would submit the poison pill to a stockholder vote that year, "a feature that further limits its inhibiting potency").

are merely anticipatory, the shareholder vote would lose much of the efficacy it has in the face of an actual offer. Similarly, a non-*Blasius* voting issue that does not relate to a transaction loses much of the force that is otherwise inherent in a shareholder vote on a transaction.[243] The weakest scenario for changing the standard of review would be a vote on the implementation of exclusive forum bylaws. Typically, shareholders have little self-interest in derivative actions as the recovery from such suits goes to the corporation's coffers, not directly to shareholders.[244] In addition to their lack of self-interest, shareholders would have little ability to evaluate the merits of a complaint and the likelihood of its success so as to decide whether the directors would be motivated to negotiate a sweetheart settlement. Therefore, the shareholders' vote on the board's implementation of an exclusive-forum bylaw serves as a weak monitor.

This is not to say that if shareholders are given the opportunity to vote on an issue and do not pay sufficient attention that courts are obligated to fill in this gap with enhanced review. Instead, the point is that the policy behind switching the standard of review due to sufficient policing through a shareholder vote is, in reality, unlikely to be meaningful if shareholders lack a sufficient self-interest.

## CONCLUSION

Although the policy issues supporting the business judgment rule, entire fairness, and *Blasius* review are broad and deep, there are some old, new, and developing scenarios where the directors' decisions do not fit neatly into any of these standards of review. Enhanced business judgment review, therefore, is an invaluable addition to the array of standards of review. By segmenting out motivational conflicts, this Article not only explains why enhanced business judgment review was appropriate in *Unocal* and *Revlon*, but also provides courts with tools to evaluate when extending enhanced review to other scenarios would be appropriate. While this Article offers up two examples for extension of enhanced review, no

243. *See* Velasco, *supra* note 241, at 623 (addressing the argument that shareholders are apathetic towards "ordinary" corporate matters and arguing that it is rational for shareholders to be less invested in and informed about such matters); Lewis v. Vogelstein, 699 A.2d 327 (Del. Ch. 1997) (reviewing the effect of shareholder ratification of a director compensation plan, and exemplifying the difference in force of a shareholder vote that does not relate to a transaction).

244. Stephen P. Ferris et al., *Derivative Lawsuits as a Corporate Governance Mechanism: Empirical Evidence on Board Changes Surrounding Filings*, 42 J. FIN. & QUANTITATIVE ANALYSIS 143, 146 (2007) ("Individual shareholders often would seem to lack sufficient economic incentive to bring a derivative suits. Derivative lawsuits are, nevertheless, made possible because of the incentives for plaintiff's counsel.").

doubt other scenarios will present themselves in the future.